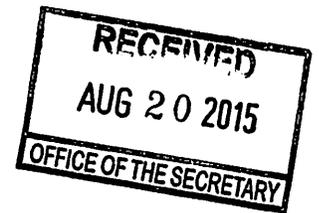


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UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549



ADMINISTRATIVE PROCEEDING  
File No. 3-16386

In the Matter of

TRACI J. ANDERSON, CPA,  
TIMOTHY W. CARNAHAN, AND  
CYIOS CORPORATION

**Expert Report of Charles R. Lundelius, Jr., CPA/ABV/CFE**

**Submitted August 19, 2015**

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Appendix A – CV

Appendix B – Materials Relied Upon

## **I. Qualifications**

1. I am the Managing Director of the Capital Markets Group at Berkeley Research Group, LLC (“BRG”), in BRG’s Washington, DC office. Prior to coming to BRG, from 1989 to 1992, I served as senior vice president and chief financial officer of the Markman Company, including its affiliate, Unimark Life Insurance Company.<sup>1</sup> At Markman, I served on the Board of Directors and was charged with corporate governance functions, which included design and supervision of a reorganization of the accounting and internal control systems. After leaving Markman, I went to Coopers & Lybrand (now PriceWaterhouseCoopers) and then Deloitte, where I investigated internal control failures and performed other forensic accounting engagements. In 2001, I came to FTI Consulting, Inc. (“FTI”), where I continued my forensic accounting work. I left FTI in January 2012 to head the practice at BRG. Over the course of the last twenty years, I have participated in numerous investigations relating to internal controls and corporate governance, including investigations relating to Freddie Mac, Refco, and New York Stock Exchange specialists Van Der Moolen and LaBranch. More recently, the SEC Inspector General asked me to lead the team of experts that investigated the SEC’s failure to uncover the Madoff Ponzi scheme. I also led and completed the independent investigation of the role of the National Futures Association in the loss of customer funds at Peregrine Financial Group, Inc.
2. I have testified in several matters brought by the SEC relating to the 2007 financial crisis. In addition, while a senior officer of a FINRA registered broker-dealer that served as lead underwriter for securities syndications, I held a General Securities Principal license (Series 24, 7 and 63) and was a Registered Investment Adviser.
3. From 1999 to 2006, I was appointed by the NASDAQ Stock Market Board of Directors to serve on the NASDAQ Listing Qualifications Panel. While I served on the panel, I heard dozens of cases involving internal control failures at NASDAQ companies that were subject to delisting. Most notably, my tenure on the Listing Panel coincided with the rise of allegations of stock option backdating among high-technology companies listed on the NASDAQ. Moreover, the passage of the Sarbanes-Oxley Act of 2002 (“SOX”) required stock exchanges to implement corporate governance rules relating to audit committee membership and qualifications through the exchange listing requirements, and I worked with NASDAQ staff in the implementation and interpretation of those standards, culminating in a presentation I made to the entire NASDAQ Listing Group in 2005 on internal control requirements under SOX.

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<sup>1</sup> During my tenure at Markman, it was the leading marketer of long-term care insurance in the U.S., placing over \$40,000,000 in annual premiums written with affiliates of Primerica Insurance. Unimark reinsured business placed with Primerica.

4. I am a Certified Public Accountant, Accredited in Business Valuation and Certified in Financial Forensics by the American Institute of Certified Public Accountants ("AICPA"). In 2003, I authored *Financial Reporting Fraud: A Practical Guide to Detection and Internal Control*, peer-reviewed and published by the AICPA, which is currently used as a textbook in academic and professional courses. The second edition of the book was released in July 2010.
5. I attach my curriculum vitae as **Appendix A**. The hourly rate that BRG charges for my time is \$900. BRG staff has assisted me on this matter, and their billing rates vary from \$100 to \$650 per hour.

## **II. Materials Relied Upon**

6. In forming my opinions in this case, I have primarily relied upon my professional experience and the documents disclosed in the footnotes or body of this report. Please refer to **Appendix B** for a list of documents relied upon for this report.

## **III. Scope**

7. I have been engaged by the SEC's Division of Enforcement ("DOE") to provide opinions regarding management's responsibilities related to internal controls at CYIOS Corporation ("CYIOS"); the materiality of public disclosures related to the alleged effectiveness of such internal controls; whether or not CYIOS' Chief Executive Officer and Principal Financial Officer<sup>2</sup> should have known that Ms. Anderson, a consultant performing accounting services on behalf of the company, had been barred by the PCAOB during 2010; and whether or not Ms. Anderson and Mr. Carnahan should have, but failed to, adhere to the relevant terms of Section 105(c)(7) of SOX, as instructed in a PCAOB disciplinary order issued during 2010 ("PCAOB Order").<sup>3</sup>

## **IV. Respondents**

### **A. Traci Jo Anderson, CPA**

8. From 2003 through August 2010, Ms. Anderson was the sole proprietor of a PCAOB-registered public accounting firm until she consented to the PCAOB Order pursuant to which she was barred from being an associated person of a registered public accounting firm. Additionally, Anderson consented in January 2012 to an order pursuant to which

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<sup>2</sup> Please note that for purposes of this report, the terms Principal Financial Officer and Chief Financial Officer ("CFO") are used interchangeably.

<sup>3</sup> PCAOB Release No. 105-2010-007, Order Instituting Disciplinary Proceedings, Making Findings, And Imposing Sanctions, In the Matter of Traci Jo Anderson and Traci Jo Anderson, CPA, Respondents, Aug. 12, 2010.

she forfeited her CPA license in North Carolina; Anderson remains licensed as a CPA in Florida.<sup>4</sup>

9. Ms. Anderson was engaged as CYIOS' external auditor from 2005 until she resigned in July 2007 to become the company's internal accountant.<sup>5</sup> Since July 2007, Ms. Anderson has functioned as a contractor providing accounting services to CYIOS.

#### **B. Timothy W. Carnahan**

10. Mr. Carnahan is the founder and is disclosed as the sole officer and director of CYIOS. Between 2006 and November 2012, Carnahan signed and certified each of CYIOS' periodic filings in the capacities of principal executive (or equivalent) and principal financial officer (or equivalent), pursuant to Section 906 of SOX and required by Rules 13a-15(d) and 15d-15(d) of the Securities and Exchange Act of 1934. Mr. Carnahan is identified as President, Chief Executive Officer, Principal Financial Officer, Principal Accounting Officer, Director, Principal and Chairman of the Board on those periodic filings.<sup>6</sup>

#### **C. CYIOS**

11. CYIOS, a Nevada corporation headquartered in Washington D.C., is a Department of Defense contractor that has provided systems integration, web and database development, business process management and improvement, and solutions for compliance with SOX regulations and Defense Contract Audit Agency and performance-based contracting for government contractors.<sup>7</sup>
12. CYIOS' common stock was registered under Section 12(g) of the Exchange Act and was traded on the OTC Bulletin Board (Symbol: CYIO).<sup>8</sup>
13. After receiving a letter dated May 12, 2014 from the Commission's Division of Corporation Finance informing CYIOS that it was not in compliance with its reporting requirements under Section 13(a) of the Exchange Act, CYIOS filed a Form 15-12G on May 30, 2014 terminating the registration of its common stock.<sup>9</sup>

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<sup>4</sup> SEC Rel. 9725, DOE Order Instituting Administrative and Cease and Desist Proceedings, Feb. 13, 2015, ¶1.

<sup>5</sup> DOE-APP000003 (Anderson Tr., 10:20-11:18).

<sup>6</sup> For example, see DOE-APP000255; DOE-APP000286-7; DOE-APP000320; DOE-APP000337; and DOE-APP000361-2.

<sup>7</sup> SEC Rel. 9725, DOE Order Instituting Administrative and Cease and Desist Proceedings, Feb. 13, 2015, ¶3.

<sup>8</sup> SEC Rel. 9725, DOE Order Instituting Administrative and Cease and Desist Proceedings, Feb. 13, 2015, ¶3.

<sup>9</sup> SEC Rel. 9725, DOE Order Instituting Administrative and Cease and Desist Proceedings, Feb. 13, 2015, ¶3.

## V. Summary of Opinions

- A. **Disclosures indicating whether or not an issuer has implemented effective internal controls are material.**
- B. **In addition, disclosures indicating whether or not an issuer has implemented “a suitable, recognized control framework that is established by a body or group that has followed due-process procedures, including the broad distribution of the framework for public comment” are also material.**
- C. **Mr. Carnahan failed to fulfill his responsibilities as Principal Financial Officer and take basic steps to verify the status of PCAOB’s investigation into Ms. Anderson’s conduct, which would have revealed that she had been barred since 2010.**
- D. **Ms. Anderson and Mr. Carnahan both failed to adhere to the terms of Section 105(c)(7) of SOX, as instructed by the PCAOB Order, which is inconsistent with COSO standards.**

## VI. Analysis

### A. **The need for effective internal controls and its applicability to the Principal Financial Officer.**

14. Over the past several decades, the importance of internal control has grown considerably. For instance, legislative and regulatory bodies began to give significant attention to internal control as a result of the 1973-1976 Watergate investigations.<sup>10</sup> In addition, the period from 1980 until 1985 saw the following development and refinement of professional standards in the auditing profession related to internal control:<sup>11</sup>
- In 1980, the AICPA issued a standard on the independent auditor’s evaluation of, and reporting on, internal control.
  - In 1982, the AICPA issued a statement that contained revised guidance concerning the independent auditor’s responsibility for the study and evaluation of internal control in a financial statement audit.

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<sup>10</sup> Internal Control – Integrated Framework, COSO (Appendix A), Sept. 1992, p. 93.

<sup>11</sup> Internal Control – Integrated Framework, COSO (Appendix A), Sept. 1992, pgs. 95-96. See also, Statement on Auditing Standards No. 30, *Reporting on Internal Accounting Control*, 1980; Statement on Auditing Standards No. 43, *Omnibus Statements on Auditing Standards*, 1982; Statement on Internal Auditing Standards No. 1, *Control: Concepts and Responsibilities*, 1983; and Statement on Auditing Standards No. 48, *The Effects of Computer Processing on the Examination of Financial Statements*, 1984.

- In 1983, the Institute of Internal Auditors published a standard that established and revised guidance to internal auditors on the nature of control and the roles of the participants in its establishment, maintenance and evaluation.
  - In 1984, the AICPA published additional guidance concerning the effects of computer processing on internal control.
15. Also, in 1985, the National Commission on Fraudulent Financial Reporting (the Treadway Commission)<sup>12</sup> established the Committee of Sponsoring Organizations (“COSO”) to investigate and set forth a standard framework against which all companies could measure their internal controls. The result of that effort was the COSO Framework, which is now considered the standard guidance on internal controls.
16. SOX, generally regarded as the most wide-sweeping legislation to affect the securities industry since the Securities Act of 1933 and the Securities Exchange Act of 1934, was passed in response to the failures of corporate governance that were pronounced in scandals such as Enron Corporation, Adelphia Communications Corporation and WorldCom.<sup>13</sup> Numerous provisions of SOX directly affect the role of CFO, such as Section 206 (conflicts of interest), Section 302 (certification of annual and quarterly reports), Section 304 (potential forfeiture of equity-based compensation due to financial statement restatement), Section 401 (accuracy of financial statements), Section 404 (assessment of internal controls), Section 409 (real-time, “plain-English” disclosures) and Section 906 (certifications of audit reports).<sup>14</sup>
17. Clearly, the role of CFO has changed over the years to be much more comprehensive and to include decision-making that extends beyond the traditional accounting and treasury functions.<sup>15</sup> The laws, regulations, and rules that a CFO must be familiar with include the following:<sup>16</sup>
- Securities and Exchange Commission reporting requirements and regulations;
  - SOX;
  - U.S. and internationally generally accepted accounting principles;
  - Internal Revenue Service reporting requirements and regulations; and the
  - U.S. Foreign Corrupt Practices Act.

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<sup>12</sup> The Treadway Commission was originally sponsored by the five main professional accounting associations and institutes in the United States: the AICPA, American Accounting Association (“AAA”), Financial Executives International (“FEI”), Institute of Internal Auditors (“IIA”), and the Institute of Management Accountants (“IMA”).

<sup>13</sup> Fabozzi, Frank J., *The Complete CFO Handbook From Accounting to Accountability*, 2008, pgs. 2, 4 and 227.

<sup>14</sup> Fabozzi, Frank J., *The Complete CFO Handbook From Accounting to Accountability*, 2008, pgs. 5-6.

<sup>15</sup> Fabozzi, Frank J., *The Complete CFO Handbook From Accounting to Accountability*, 2008, p. 1.

<sup>16</sup> Fabozzi, Frank J., *The Complete CFO Handbook From Accounting to Accountability*, 2008, p. 7.

18. Frank Fabozzi, CPA/CFA and a well-published finance professor, stated that a typical job description for a CFO could appear as follows:<sup>17</sup>

**JOB DESCRIPTION:** Oversee financial accounting systems, reporting, and disclosures; assure compliance of financial reporting with generally accepted accounting principles and securities law accounting requirements; assure compliance with local government, federal government, and international tax laws, regulations, and rules; expert in disclosure compliance with federal and state securities laws; **establish, monitor, and evaluate internal controls**; work with the CEO in the development of strategic goals and plans, execute the strategic plans, and evaluate performance relative to the strategic goals; participate in long-term and short-term budgeting; exceptional communication and team leadership skills; able to raise capital and manage the firms' capital structure to maximize the value of the company and minimize the company's cost of capital; **develop, monitor, and evaluate a program of risk management**; communicate with the company's Board of Directors, shareholders, creditors, and credit rating agencies; no sensitivity to the effects of kryptonite. (Emphasis added.)

19. Although the reference from the passage directly above stating, "no sensitivity to the effects of kryptonite", is meant to add some levity to the job description, it underscores the expectations regarding the vast depth of expertise required of a CFO, including the development, monitoring, and evaluation of both internal controls and a program of risk management.
20. Similarly, Steven Bragg, a well-published accounting expert, identified the following CFO responsibilities:<sup>18</sup>

**SPECIFIC CFO RESPONSIBILITIES:** Pursue shareholder value; **construct reliable control systems; understand and mitigate risk**; link performance measures to strategy; encourage efficiency improvements everywhere; clean up the accounting and finance functions; install shared services; examine outsourcing possibilities; allocate resources; and encourage innovation. (Emphasis added.)

**B. The relevant framework for evaluating internal control and governance structures.**

21. In this section, I discuss the appropriate standard against which a company's internal controls and governance structures may be measured.

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<sup>17</sup> Fabozzi, Frank J., *The Complete CFO Handbook From Accounting to Accountability*, 2008, p. 1.

<sup>18</sup> Bragg, Steven M., *The New CFO Financial Leadership Manual*, Second Edition, 2007, pgs. 4-7.

22. COSO defines internal controls as the process, effected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:<sup>19</sup>
- **Operations** – The effective and efficient use of an entity's resources.
  - **Financial Reporting** – The preparation of reliable published financial reports.
  - **Compliance** – Compliance with applicable laws and regulations.
23. Thus, internal controls that meet COSO standards can be expected to provide management and Board members with reasonable assurance of effective operations, reliable financial reporting and compliance with laws and regulations.
24. COSO states that internal controls should be made up of five interrelated components. These components consist of the following:<sup>20</sup>
- **Control Environment** – The core of any business is its people – their individual attributes, including integrity, ethical values and competence – and the environment in which they operate. They are the engine that drives the entity and the foundation on which everything rests.
  - **Risk Assessment** – The entity must be aware of and deal with the risks it faces. It must set objectives, integrated with the sales, production, marketing, financial and other activities so that the organization is operating in concert. It also must establish mechanisms to identify, analyze, and manage the related risks.
  - **Control Activities** – Control policies and procedures must be established and executed to help ensure that the actions identified by management as necessary to address risks to achievement of the entity's objectives are effectively carried out.
  - **Information and Communication** – Surrounding these activities are information and communication systems. These enable the entity's people to capture and exchange the information needed to conduct, manage and control its operations.
  - **Monitoring** – The entire process must be monitored, and modifications made as necessary. In this way, the system can react dynamically, changing as conditions warrant.
25. COSO's goal is to provide a framework for designing and implementing internal controls that can promote effective operations, accurate financial reporting, and compliance with

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<sup>19</sup> Internal Control – Integrated Framework, COSO (Framework), Sept. 1992, pgs. 13 and 16.

<sup>20</sup> Internal Control – Integrated Framework, COSO (Framework), Sept. 1992, pgs. 16-18.

laws and regulations. The internal controls promoted by the COSO Framework would include operational controls over the accuracy and adequacy of disclosures such as those at issue in this case. COSO accomplishes this goal in part by ensuring that information is timely and properly shared and communicated in an organization.

26. Guidance by the Public Company Accounting Oversight Board (“PCAOB”)—which was established by SOX to promulgate audit standards for SEC registrants—has confirmed that the COSO Framework is an appropriate standard by which SEC registrants may assess the efficacy of their internal controls. In its Auditing Standard Number 5 (“AS 5”), *An Audit of Internal Control Over Financial Reporting Performed That Is Integrated with An Audit of Financial Statements*, PCAOB stated that the COSO Framework “provides such a framework” for purposes of management’s assessment of a company’s internal controls and therefore provides a reasonable system of supervision and internal control.<sup>21</sup>
27. PCAOB’s endorsement of the COSO Framework is particularly significant because it was made in response to Section 404 of SOX, Management Assessment of Internal Controls (“SOX 404”), and its implementing regulations, which require management to assess the effectiveness of a company’s internal controls over financial reporting based upon “a suitable, recognized control framework that is established by a body or group that has followed due-process procedures, including the broad distribution of the framework for public comment.”<sup>22</sup>

**C. Disclosures indicating whether or not an issuer has implemented effective internal controls are material.**

28. It is widely-recognized in the securities industry that information is “material” if reasonable investors would want to know the information before making an investment decision. In other words, information is material if it would significantly alter the total mix of information currently available about a security.<sup>23</sup>
29. Rules 13a-15(d) and 15d-15(d) of the Securities and Exchange Act of 1934 require quarterly evaluation of any change in internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, internal control over financial reporting. In particular, both rules require management to evaluate, with the Principal Executive and Principal Financial Officer’s participation, “any change in the issuer’s internal control over financial reporting, that occurred during each of the issuer’s

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<sup>21</sup> See footnote 7 of Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That is Integrated With an Audit of Financial Statements*, effective for fiscal years ending on or after Nov. 15, 2007.

<sup>22</sup> SEC Release 33-8238, Jun. 5, 2003.

<sup>23</sup> CFA Institute, *Standards of Practice Handbook*, Tenth Edition 2010, p. 49. See also, SEC Rel. 2786, Order on Motions for Summary Disposition, Jun. 9, 2015, p.7, which states: “Materiality is satisfied if there is a substantial likelihood that an accurate disclosure would have been viewed by a reasonable investor as having ‘significantly altered the total mix of information made available.’”

fiscal quarters...that has materially affected, or is reasonably likely to materially affect, the issuer's internal control over financial reporting."<sup>24</sup>

30. It is widely accepted that the effectiveness, or lack thereof, of internal controls may have a material effect on the issuer's internal control over financial reporting. This information is material to investors because the lack of effectiveness of internal controls calls into question the accuracy of an issuer's public disclosures, which are an important piece of information investors rely on when making investment decisions. Therefore, a reasonable investor would consider the effectiveness of internal controls important when making investment decisions.

**D. In addition, disclosures indicating whether or not an issuer has implemented "a suitable, recognized control framework that is established by a body or group that has followed due-process procedures, including the broad distribution of the framework for public comment" are also material.**

31. Also discussed above, SOX and its implementing regulations requires "a suitable, recognized control framework that is established by a body or group that has followed due-process procedures, including the broad distribution of the framework for public comment." A control framework that failed to meet the requirements of SOX would raise serious doubts about the effectiveness of such framework, the credibility of the issuer and its management and the reliability of the financial results represented by the financial statements.
32. As a result, an issuer's lack of a suitable, recognized framework for internal control would be material information to investors because a reasonable investor would consider the lack of a suitable, recognized framework for internal control important when making investment decisions.

**E. Mr. Carnahan failed to fulfill his responsibilities as Principal Financial Officer and take basic steps to verify the status of PCAOB's investigation into Ms. Anderson's conduct, which would have revealed that she had been barred since 2010.**

33. Ms. Anderson indicated during her sworn testimony on July 25, 2014 that she told Mr. Carnahan that she had been barred by the PCAOB and had directed him to the relevant

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<sup>24</sup> Rules 13a-15(d) and 15d-15(d) of the Securities and Exchange Act of 1934 (17 CFR 240.13a-15; 17 CFR 240.15d-15).

order (PCAOB Order) located on the PCAOB website. The relevant excerpt<sup>25</sup> from the transcript of Ms. Anderson's sworn testimony is shown below:

Anderson Excerpt 1:<sup>26</sup>

[Question] Okay. When did you tell Tim Carnahan about the existence of the legal order?

[Answer] I don't remember.

[Question] Okay. **How did you tell him?**

[Answer] I just said I will no longer be doing audits. Those are all going to other -- the first time was the -- yeah, they're all going to other audit firms. **And here -- there's my order, there's the PCAOB website. If you have any questions, let me know.**

[Question] Did you notify him in writing?

[Answer] No.

[Question] Was this in a telephone call?

[Answer] Yes, it was -- actually, I think it may have been there with him and Jodie. It seems like I told them at the same time but maybe it was just two different phone calls.

[Question] Okay. **Was it soon after the order was issued?**

[Answer] **Oh, I would say by -- yeah, within a month or so. I mean, it seems to be.**

34. It appears, at the very least, that Ms. Anderson notified Mr. Carnahan that she was being investigated by the PCAOB for her professional conduct. Mr. Carnahan acknowledged as

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<sup>25</sup> For purposes of including transcript or other excerpts in this report, I have omitted line numbers from the original transcripts and emphasized certain passages in bold font.

<sup>26</sup> DOE-APP000023 (Anderson Tr., 90:19-91:12).

much in multiple instances during his sworn testimony taken on June 19, 2014, as shown below:

Carnahan Excerpt 1:<sup>27</sup>

[Question] So David was asking you whether or not you're aware that Traci Jo Anderson was subject to a PCAOB disciplinary proceeding dated August of 2010, during her time period that she's been associated with CYIOS and with you.

[Answer] **I think I was aware that something happened with her many years ago that they asked her some questions.** I -- I was aware of some skin on something that was going on, but I didn't know any of the details.

[Question] Sorry. Did you say some skin on something?

[Answer] Yes. Like, "Hey. I have to deal with" -- **she took a day off or something to deal with some PCAOB. Let's call an investigation in my book. So she did tell me something like that, yeah.**

Carnahan Excerpt 2:<sup>28</sup>

[THE WITNESS] **I think she did tell me that she was going through something with the PCAOB.** I've never seen this document [referencing the PCAOB Order].

Carnahan Excerpt 3:<sup>29</sup>

[Question] So I understood from your comment earlier that **you were at least superficially aware of something with the PCAOB and with Traci Anderson.**

[Answer] **Yeah, yeah. I remember that.**

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<sup>27</sup> DOE-APP000067 (Carnahan Tr., 86:10-23).

<sup>28</sup> DOE-APP000067 (Carnahan Tr., 88:3-5).

<sup>29</sup> DOE-APP000068 (Carnahan Tr., 89:7-10).

35. Mr. Carnahan testified that he “probably did” ask Ms. Anderson about the resolution to the PCAOB matter, but did not recall the specific conversation:

Carnahan Excerpt 4:<sup>30</sup>

[Question] Okay. **Did you ever ask her about the resolution of that matter?**

[Answer] **I don't recall I did. I probably did or she probably brought it up.** To my knowledge today, I don't think anything ever transpired that it was so negative I felt it was a threat to my internal controls, unless it was hidden from me.

[Question] Hidden from you by Traci Anderson?

[Answer] Well I didn't -- I mean I don't know of any problems. I'll put this over here. I've never seen that. But I don't have any problems that I would be alarmed to.

[Question] Okay.

[Answer] **But I'm not saying she didn't tell me or I didn't know about it, because she tells me things.** And I'm more worried about other things. I -- I -- if it's not at the matter at hand, then I'm not going to, you know. I've handled it, and if I've handled it, then it's done. I kind of put it back; I can go forward. The brick is solid. Move forward. **So don't take me exclusively like I didn't hear about it,** I never saw it. I have never seen this. I can be definitive on that.

36. Mr. Carnahan was also unable to recall if Ms. Anderson's PCAOB bar had been raised by the company's auditor, but indicated if it had been raised by the auditor, he may have not deemed it relevant to his job:

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<sup>30</sup> DOE-APP000068 (Carnahan Tr., 89:11-90:7).

Carnahan Excerpt 5:<sup>31</sup>

[Question] And just to confirm, it sounded like you said that none of the auditors has ever brought to your attention the fact that there was this order out there against Traci Anderson. Is that accurate?

[Answer] **Yeah. I don't recall an auditor saying, hey, and pulling me aside and saying there's this order instituting -- whatever it says there. No. No one's ever come and told me that. I don't recall that anyone has. Maybe they have and I just didn't pay attention. It wasn't [relevant] to me getting my job done. A lot of people talk to me and tell me stuff.**

37. Mr. Carnahan later explained that he would be more concerned if the company's auditor had been barred by the PCAOB, as opposed to Ms. Anderson:

Carnahan Excerpt 6:<sup>32</sup>

[Question] Okay. And had you known about this, would it be something that would alarm you?

[Answer] Yeah. I would have reacted. Of course, I would have reacted and figured out do I need to be alarmed. What's this all about? How does this affect me? **If she was my auditor under investigation, I think that would be a problem.** If she's under investigation, I don't need to hire someone to be my external auditor.

[Question] Well to be accurate you were aware that there was -- and in fact you used the word "investigation" earlier. You were aware that there's a PCAOB interest investigation related to Traci Anderson. Is it your thought that that would only be an issue for CYIOS if Traci Anderson was your external auditor as opposed to the internal accounting function for CYIOS?

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<sup>31</sup> DOE-APP000068 (Carnahan Tr., 91:21-92:6).

<sup>32</sup> DOE-APP000069 (Carnahan Tr., 93:8-94:3).

**[Answer] I don't see how it could affect my internal operations. I told you. I work with internal controls and make sure they're reasonable. If I feel like they're reasonable, then I'm the one that has to be judged here. I don't think she's going to change my internal control processes.**

38. It is my understanding that during the relevant time period, Mr. Carnahan regularly utilized Ms. Anderson as a consultant to provide accounting services and to utilize "her skills as a CPA any which way I can to get my job done."<sup>33</sup> Ms. Anderson generally testified she has provided substantive accounting assistance to Mr. Carnahan over several years, such as "maintaining the Quickbooks"; "making sure the bills are paid"; assisting with invoices; collecting receivables; assisting with payroll; ensuring taxes are paid; and assisting with special projects.<sup>34</sup> According to Mr. Carnahan's testimony, Ms. Anderson "[did] the financials"; "[did] her financial reporting accounting world stuff"; provided input on issues related to revenue recognition; complied and recorded information in CYIOS' QuickBooks accounting system; and prepared CYIOS' tax returns.<sup>35</sup>
39. Based on Ms. Anderson's and Mr. Carnahan's descriptions of Ms. Anderson's activities at CYIOS, her job functions appear to overlap with the job functions of a corporate controller. Below is a chart listing typical job responsibilities for both a CFO and a controller.<sup>36</sup> Areas that apply to Ms. Anderson have been highlighted with arrows:

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<sup>33</sup> DOE-APP000067 (Carnahan Tr., 85:5-12).

<sup>34</sup> DOE-APP000004-5 (Anderson Tr., 14:19-19:12).

<sup>35</sup> DOE-APP000053 (Carnahan Tr., 29:4-14); DOE-APP000056-57 (Carnahan Tr. 43:18-44:10; 44:13-46:5; 47:18-48:13); and DOE-APP000074 (Carnahan Tr.; 114:11-17).

<sup>36</sup> Bragg, Steven M., *The New CFO Financial Leadership Manual*, Second Edition, 2007, p. 10.

Area of Responsibility	CFO	Controller
Accounting		
Assist with the annual audit	X	X
Pay accounts payable on time		X
Collect accounts receivable		X
Take discounts on accounts payable		X
Issue billings promptly		X
Calculate job costs		X
Complete bank reconciliations		X
Issue management reports	X	X
Issue financial statements	X	X
File information with the SEC	X	X
Maintain policies and procedures		X
Maintain the chart of accounts		X
Manage outsourced functions		X
Manage the accounting staff		X
Manage the budgeting process	X	X
Review capital requests	X	
Process payroll		X
Implement operational best practices	X	X
Provide financial analysis	X	X
Develop performance measurements	X	
Maintain performance measurements		X
Review control weaknesses	X	X
Finance		
Formulate financial strategy	X	
Formulate tax strategy	X	
Formulate risk management strategy	X	
Negotiate acquisitions	X	
Maintain banking relations	X	
Arrange for debt financing	X	
Conduct equity placements	X	
Invest funds	X	
Invest pension funds	X	
Issue credit to customers		X
Maintain insurance coverage	X	
Monitor cash balances		X
Maintain investor relations	X	

40. In addition, Ms. Anderson was publicly touted on CYIOS' website as a key member of the CYIOS team. In fact, her bio that was posted on the company website described her as "CFO" with the following job responsibilities:<sup>37</sup>

Ms. Anderson serves as a CFO for CYIOS, responsible for the day-to-day financial operations. Experienced in the field of government contract finance, Ms. Anderson is responsible for the management of contracts related to maintenance, funding and invoicing, as well as preparation of DCAA and SEC audits and interfacing with CYIOS program managers to ensure that financial contractual requirements are met. Reporting directly to the CEO, she advises him on financial, resource, and business planning, including budgeting and forecasting, and oversees all aspects of the organization's accounting function. Ms. Anderson is responsible for planning and directing the Company's ledger accounts, financial statements, and cost control systems, as well as responsible for directing the Company's accounting functions which

<sup>37</sup> DOE-APP000127-8 (DOE Exh. 6).

include establishing and maintaining the organization's accounting principles, practices, procedures and initiatives.

41. Ms. Anderson testified that she has never served as "CFO" of CYIOS, but instead, has provided "CFO consulting services."<sup>38</sup> Interestingly, both Ms. Anderson and Mr. Carnahan have downplayed the significance of Ms. Anderson's qualifications and experience in her bio that was posted on the company website. For instance, in her sworn testimony Ms. Anderson stated the following:

Anderson Excerpt 2:<sup>39</sup>

[Question] Okay. He also indicates that you oversee all aspects of the organization's accounting function, is that correct?

[Answer] Yes. I mean, it's a little -- **it makes it sound a little more important of a role than it is.** I mean, it's so -- I mean, I don't know that I oversee it. I'm the one that's basically doing it, you know. **I would have to say I disagree with that.**

[Question] Okay. Is that because that makes it seem like there are others that you're overseeing?

[Answer] Exactly.

[Question] Okay.

[Answer] Exactly.

[Question] And in reality, you're overseeing yourself?

[Answer] Well, Tim's overseeing me. So yes.

[Question] Okay. All right. And then it indicates that you're responsible for planning and directing the company's ledger accounts, financial statements and cost control systems. Is that correct?

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<sup>38</sup> DOE-APP000004 (Anderson Tr. 14:7-18).

<sup>39</sup> DOE-APP000019-20 (Anderson Tr. 76:20 - 77:16).

[Answer] I'm not sure what is meant by directing the company's ledger accounts. I don't know where he got that. I don't know what is meant by that.

42. Later, Ms. Anderson's testimony on the same topic continues as follows:

Anderson Excerpt 3:<sup>40</sup>

[Question] When Mr. Carnahan provided you with this text, did you comment to him, like, hey, maybe **this is embellishing a little bit?** Or –

[Answer] **Yes.**

[Question] Can you tell me about that communication with him?

[Answer] I just said I think it's -- you're **making my role seem so big.** And he's like, well, we've got to seem like a big company, you know. **It's great marketing.**

[Question] What did he mean by that, we need to seem like a big company?

[Answer] **Bigger company that -- not that there's just one person in accounting. I mean, he likes to impress. You know, he wants to impress and look good, and it's marketing is what he explained to me it is.**

43. For his part, Mr. Carnahan commented on Ms. Anderson's website bio as follows:

Carnahan Excerpt 7:<sup>41</sup>

[Question] And, in fact, I mean it was enough to put on your web page as recently as May 27th of this year that

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<sup>40</sup> DOE-APP000020 (Anderson Tr. 78:23-79:13).

<sup>41</sup> DOE-APP000069 (Carnahan Tr., 94:22-95:13).

she's the CFO with these principal responsibilities.

[Answer] That's probably still there now.

[Question] Probably; I don't know, but it was as of May 27th.

[Answer] Yeah. Yeah, **I treat that as a website is a marketing thing**, and the reason I didn't stick to what you said -- 2010, does this apply to 2010 -- **well I probably looked at her resume or thought, asked her, you know, what's the broad picture of what you do**. Now, when you hone down into my internal controls, you know, I don't see taking that and applying it, making it applicable to my internal controls. That's applicable to someone who's reading about do we have a CFO that can do all this. **That's more of a capability statement rather than a statement of what she's doing internally.**

44. Without the benefit of Ms. Anderson and Mr. Carnahan's commentary above, Ms. Anderson's website bio appears misleading because it apparently overstates her duties, responsibilities and importance at CYIOS (i.e., "CFO"). If that is the case, it suggests CYIOS had controls in place for segregation of certain financial and accounting duties that may not actually exist.
45. Assuming Mr. Carnahan was not directly informed of the PCAOB bar as Ms. Anderson stated in her testimony, Mr. Carnahan apparently made no effort to independently verify the status or disposition of the investigation he had learned about regarding Ms. Anderson's professional activities. Even given that Ms. Anderson may not have served as CFO, Mr. Carnahan regularly relied on her to provide substantive assistance and accounting expertise over several years. Given the scope of her duties at CYIOS, any regulatory inquiry into her professional activities was completely relevant to her overall competence and work she performed for CYIOS.
46. Had Mr. Carnahan been interested in independently confirming the final resolution of the PCAOB investigation of Ms. Anderson, he clearly was capable and knowledgeable enough to do so. For instance, Mr. Carnahan explained that he was sufficiently familiar with PCAOB and could conduct his own due diligence with regard to vetting prospective auditors:

Carnahan Excerpt 8:<sup>42</sup>

[Question] Okay. So in terms of, I guess, beginning engaging the auditors, that's something that you do?

[Answer] Well I can find the auditor, and I would ask her to give me the vitals. So she would do some research and say, or this is what they do. This is their clients. This is what their base price has been. Because I think it's on the back of 10-K somewhere. You can find how much they charge for the last audit. So, and she'll do research like that and I'll compare quickly and make a decision.

[Question] So it's fair to say she gives certain input into who to hire, but it sounds like the ultimate decision who to hire is your decision.

[Answer] **Well, yeah. I know about the PCAOB Board. I look them up. I do my research.** So I don't really need her to do that. But, certainly, if I'm over here, like in a meeting, she can help me out. But, ultimately, I'm making the decision. Yeah.

47. More importantly, once Mr. Carnahan learned of the PCAOB investigation of Ms. Anderson, it was well within the role and responsibilities as Principal Financial Officer to adequately monitor the situation and independently confirm the resolution of the PCAOB investigation of Ms. Anderson, whether she notified him of the final resolution or not.
48. As shown below, relevant guidance provided by COSO highlights Mr. Carnahan's responsibilities, as Principal Financial Officer, with regard to recognizing and addressing the seriousness of an ongoing PCAOB investigation of Ms. Anderson's professional activities. These responsibilities all relate to effectively implementing a framework of internal control that addresses relevant ethical and behavioral conduct, as well as professional disciplinary activity.
49. For instance, COSO guidance illustrates the importance of emphasizing human resource policies and practices relevant to internal control as follows:<sup>43</sup>

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<sup>42</sup> DOE-APP000059 (Carnahan Tr., 53:4-21).

Human resource practices send messages to employees regarding **expected levels of integrity, ethical behavior and competence**. Such practices relate to hiring, orientation, training, evaluating, counseling, promoting, compensating and **remedial actions**. For example, standards for hiring the most qualified individuals, with emphasis on educational background, prior work experience, past accomplishments and evidence of integrity and ethical behavior, demonstrate an entity's commitment to competent and trustworthy people. Recruiting practices that include formal, in-depth employment interviews and informative and insightful presentations on the entity's history, culture and operating style send a message that the entity is committed to its people. Training policies that communicate prospective roles and responsibilities and include practices such as training schools and seminars, simulated case studies and role-play exercises, illustrate expected levels of performance and behavior. Rotation of personnel and promotions driven by periodic performance appraisals demonstrate the entity's commitment to the advancement of qualified personnel to higher levels of responsibility. Competitive compensation programs that include bonus incentives serve to motivate and reinforce outstanding performance. **Disciplinary actions send a message that violations of expected behavior will not be tolerated.**

50. The above COSO guidance clearly identifies the need to emphasize ethical behavior, competence and implement a control framework where disciplinary actions send a message that violations of expected behavior will not be tolerated. An ongoing disciplinary investigation of Ms. Anderson's activities should have alerted Mr. Carnahan that Ms. Anderson's ethical behavior and competence could be in question, which is directly relevant to such guidance.
51. Along those lines, COSO guidance states human resource policies and practices should address the following:<sup>44</sup>
  - Appropriateness of remedial action taken in response to departures from approved policies and procedures. For example, consider whether:
    - Management's response to failures to carry out assigned responsibilities is appropriate.

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<sup>43</sup> Internal Control – Integrated Framework, COSO (Control Environment), Sept. 1992, p. 29.

<sup>44</sup> Internal Control – Integrated Framework, COSO, Evaluation Tools (Control Environment), Sept. 1992, pgs. 17-18.

- **Appropriate corrective action is taken as a result of non-adherence to established policies.**
- Employees understand that ineffective performance will result in remedial consequences.
- Adequacy of employee retention and promotion criteria and information-gathering techniques (e.g., performance evaluation) and relation to the code of conduct or other behavioral guidelines. For example, consider whether:
  - Promotion and salary increase criteria are detailed clearly so that individuals know what management expects prior to promotions or advancement.
  - **Criteria reflect adherence to behavioral standards.**

52. The control environment should also address the following:<sup>45</sup>

- Appropriateness of remedial action taken in response to departures from approved policies and procedures or violations of the code of conduct. Extent to which remedial action is communicated or otherwise becomes known throughout the entity. For example, consider whether:
  - **Management responds to violations of behavioral standards.**
  - **Disciplinary actions taken as a result of violations are widely communicated in the entity. Employees believe that, if caught violating behavioral standards, they'll suffer the consequences.**

53. Evaluation of internal controls should include the following:<sup>46</sup>

- Existence and **implementation** of codes of conduct and other policies regarding acceptable business practice, conflicts of interest, or expected standards of ethical and moral behavior.

54. Some examples of ongoing monitoring activities include the following:<sup>47</sup>

- Communications from external parties corroborate internally generated information or indicate problems.

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<sup>45</sup> Internal Control – Integrated Framework, COSO Evaluation Tools (Control Environment), Sept. 1992, p. 6.

<sup>46</sup> Internal Control – Integrated Framework, COSO (Control Environment), Sept. 1992, p. 31.

<sup>47</sup> Internal Control – Integrated Framework, COSO (Monitoring), Sept. 1992, pgs. 70-71.

- Regulators may also communicate with the entity on compliance or other matters that reflect on the functioning of the internal control system.
  - **Personnel are asked periodically to state explicitly whether they understand and comply with the entity's code of conduct.**
  - **Personnel are also asked to regularly perform critical control activities. For example, consider whether:**<sup>48</sup>
    - **Personnel are required periodically to acknowledge compliance with the code of conduct.**
    - Signatures are required to evidence performance of critical control functions, such as reconciling specified amounts.
55. Based on the above COSO guidance, it is clear that effective internal controls provide a proper framework to address ethical behavior and disciplinary activity. Consistent with these COSO guidelines, Mr. Carnahan, as Principal Financial Officer, had an obligation to address an ongoing regulatory investigation of a key team member, but failed to do so.
56. For instance, had Mr. Carnahan periodically required personnel to explicitly state whether they understood and complied with CYIOS' code of conduct, he likely would have acknowledged and documented the status of the PCAOB investigation based on periodic signed certifications from Ms. Anderson. Mr. Carnahan then should have independently verified the status by contacting PCAOB personnel directly or utilizing its website to see if a final resolution had been publicly disclosed.
57. Given the scope of Ms. Anderson's duties and Mr. Carnahan's dependence on her for assistance over the years, the direct relevance of the regulatory investigation of Ms. Anderson's professional activities should have been readily apparent to Mr. Carnahan, and given other contributing risk factors (discussed below), should have been given his full attention and reasonable care acting as Principal Financial Officer.
58. One contributing risk factor was key person risk. Given Mr. Carnahan's unique, multi-faceted leadership role at CYIOS, he was disclosed as a key person risk in its SEC filings:<sup>49</sup>

**The loss of our Chief Executive Officer could have a material adverse effect on our business.**

Our success depends to a large degree upon the skills, network and professional business contacts of our Chief Executive Officer, Timothy

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<sup>48</sup> Internal Control – Integrated Framework, COSO Evaluation Tools (Monitoring), Sept. 1992, p. 38.

<sup>49</sup> DOE-APP000264 (CYIOS 2010 Form 10-K/A, Amendment No. 2).

Carnahan. We presently do not maintain key person life insurance on, and have no employment agreement with, Timothy Carnahan, and there can be no assurance that we will be able to retain him or, should he choose to leave us for any reason, to attract and retain a replacement or additional key executives. **The loss of our Chief Executive Officer would have a material adverse effect on our business, our financial condition, including liquidity and profitability, and our results of operations, raising substantial doubts as to our ability to continue as a going concern.**

59. Key person risk was also indirectly acknowledged by Mr. Carnahan when discussing the internal control framework at CYIOS:

Carnahan Excerpt 9:<sup>50</sup>

[Question] Is it the practice of you and the company to document assessments of internal controls as you do them periodically?

[Answer] Is it? **I am the internal control, so I don't document myself.**

60. Ms. Anderson recognized that Mr. Carnahan effectively served as the sole control at CYIOS:

Anderson Excerpt 4:<sup>51</sup>

[Question] Okay. Other than Mr. Carnahan asking you to review a copy of the 10-Q or 10-K, is there anything else he asks you to do to help him decide whether or not disclosures controls and procedures or internal control of financial reporting are effective?

[Answer] **No, because he -- I mean, it's on a day-to-day basis.** I mean, the controls are there on a day-to-day basis. He looks at the bank account and he'll tell me, okay, why do we only have this much money? Let's look, you know, up. It goes from that nitty gritty to on the financials, if he's looking at them and something's not right, or payroll is off, I mean, he knows and he'll ask

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<sup>50</sup> DOE-APP000063 (Anderson Tr., 72:15-19).

<sup>51</sup> DOE-APP000014 (Anderson Tr., 55:11-23).

me. He'll question me. **He's my control.**

61. Ms. Anderson also was unaware of any mechanisms in place to prevent Mr. Carnahan for overriding any existing controls at CYIOS:

Anderson Excerpt 5:<sup>52</sup>

[Question] Okay. Are there any controls in place -- let me ask it differently.

**What controls are in place to prevent Mr. Carnahan for overriding any existing controls of the company?**

[Answer] **What are controls that he can override?**

[Question] Yes.

[Answer] **Oh, it's his company. I mean, I don't know.**  
As far as -- I mean, I don't know. I'm not quite sure I understand.

62. Another contributing risk factor is lack of a fully operational Board of Directors at CYIOS. Mr. Carnahan readily acknowledged the lack of a Board of Directors:

Carnahan Excerpt 10:<sup>53</sup>

**I don't have a board of directors. I've always wanted one, but I never had one.**

63. Guidance and commentary provided by COSO succinctly illustrates the importance of an effective Board of Directors in conjunction with effective management:

[M]anagement is responsible for the internal control system, and is accountable to the board for establishing a system that provides reasonable assurance with respect to achievement of the entity's objectives. The board, in turn, provides governance, guidance and oversight.<sup>54</sup>

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<sup>52</sup> DOE-APP000016 (Anderson Tr., 63:8-17).

<sup>53</sup> DOE-APP000054 (Carnahan Tr., 33:15-16).

<sup>54</sup> Internal Control – Integrated Framework, COSO (Considerations of Comment Letters), Sept. 1992, p. 116.

**An active and effective board, or committees thereof, provides an important oversight function and, because of management's ability to override system controls, the board plays an important role in ensuring effective internal control.<sup>55</sup>**

64. The key man risk, Mr. Carnahan's role as the sole control at CYIOS and lack of a fully operational Board of Directors highlights the likely breakdown that may occur when Mr. Carnahan personally is unable to recognize a risk or problem (i.e., regulatory investigation of Ms. Anderson) at CYIOS: there is no backstop or additional control in place to address such issues as they arise.
65. Given the scope of Ms. Anderson's duties at CYIOS, the relevant COSO guidance addressing ethical behavior and competence, Mr. Carnahan should have followed up on the status of the ongoing PCAOB investigation independent of what Ms. Anderson may or may not have told him regarding its resolution.
66. Had Mr. Carnahan exercised reasonable care upon learning of the investigation into Ms. Anderson's professional conduct, he would have independently confirmed the status of the investigation until final resolution and then would have disciplined Ms. Anderson accordingly and at the very least, considered the impact on the internal control structure.

**F. Ms. Anderson and Mr. Carnahan both failed to adhere to the terms of Section 105(c)(7) of SOX, as instructed by the PCAOB Order.**

67. As explained above, COSO provides the framework to implement internal controls to ensure integrity, ethical values and a commitment to competence.<sup>56</sup> Inherent in this framework is the commitment to comply with all applicable rules and regulations governing an organization's professional activities. In order to fulfill these COSO requirements, Ms. Anderson and Mr. Carnahan were obligated to make reasonable efforts to understand and comply with the terms of the PCAOB Order, which was the direct result of a PCAOB regulatory enforcement action related to Ms. Anderson's professional activities. Ms. Anderson and Mr. Carnahan were also required to comply with SOX and the rules and regulations thereunder.
68. The PCAOB Order states the following with regard to SOX, which was directly applicable to the enforcement action against Ms. Anderson:<sup>57</sup>

The Board deems it necessary and appropriate, for the protection of investors and to further the public interest in the preparation of informative,

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<sup>55</sup> Internal Control – Integrated Framework, COSO Evaluation Tools (Control Environment), Sept. 1992, p. 8.

<sup>56</sup> See also, Internal Control – Integrated Framework, COSO (Control Environment), Sept. 1992, p. 31.

<sup>57</sup> PCAOB Order, p. 1

fair, and independent audit reports, that disciplinary proceedings be, and hereby are, instituted pursuant to **Section 105(c) of the Sarbanes-Oxley Act of 2002** ("Act") and PCAOB Rule 5200(a)(1) against the Firm and Anderson.

69. Section 105(c)(7)(A) of SOX states the following:

**ASSOCIATION WITH A PUBLIC ACCOUNTING FIRM.—**  
It shall be unlawful for any person that is suspended or barred from being associated with a registered public accounting firm under this subsection willfully to become or remain associated with any registered public accounting firm, or for any registered public accounting firm that knew, or, in the exercise of reasonable care should have known, of the suspension or bar, to permit such an association, without the consent of the Board or the Commission.

70. Section 105(c)(7)(B) of SOX states the following:

**ASSOCIATION WITH AN ISSUER.—**It shall be unlawful for any person that is suspended or barred from being associated with an issuer under this subsection willfully to become or remain associated with any issuer in an accountancy or a financial management capacity, and for any issuer that knew, or in the exercise of reasonable care should have known, of such suspension or bar, to permit such an association, without the consent of the Board or the Commission.

71. It would be impossible for either Ms. Anderson or CYIOS (acting through Mr. Carnahan) to comply with the terms of the PCAOB Order without complying with the requirements of Section 105(c)(7) of SOX. In particular, they were required to comply with Section 105(c)(7)(B), which directly affects Ms. Anderson's ability to fulfill her duties and responsibilities at CYIOS.
72. Mr. Carnahan failed to comply with SOX and the COSO standards noted above because he, as Principal Financial Officer, allowed Ms. Anderson to continue working in an accountancy or financial management capacity at CYIOS, an issuer, in direct contravention to the terms of the PCAOB Order and Section 105(c)(7)(B) of SOX. That failure was severe in that he was on notice of a potential PCAOB violation, at the least.

73. Ms. Anderson also failed to comply with SOX and the COSO standards noted above because she failed to withdraw from working in an accountancy or financial management capacity at CYIOS, an issuer, in direct contravention to the PCAOB Order and Section 105(c)(7)(B) of SOX. That failure was severe in that Ms. Anderson was on notice in the text of the PCAOB Order itself that she was being disciplined pursuant to Section 105(c)(7) of SOX.
74. To the extent my work on this matter is ongoing, and I may review additional materials or conduct further analysis. I reserve the right to update, refine, or revise my opinions as necessary. I reserve the right to update my opinion and report as new information becomes available.



Charles R. Lundelius, Jr.

Submitted August 19, 2015

### APPENDIX A

**CHARLES R. LUNDELIUS, JR.**  
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Charles Lundelius is the Managing Director of BRG's Financial Institutions Practice, specializing in regulation of and securities trading by broker-dealers, investment advisers, hedge funds, insurance companies and banks. He consults with and provides expert testimony on behalf of clients in the areas of:

- securities and accounting fraud,
- investment management,
- complex investor suitability,
- insider trading,
- stock manipulation,
- securities market regulation,
- securities valuation and share price modeling,
- financial accounting and internal control standards, and
- commodity futures trading regulation and accounting.

As an expert witness over the past twenty years, Mr. Lundelius has testified in over fifty different cases. When the United States Securities and Exchange Commission ("SEC") identified key cases it brought relating to the 2007 financial crisis, Mr. Lundelius had testified or was asked to testify in three of those matters.<sup>1</sup> Also, among Mr. Lundelius' more notable consulting engagements, the SEC Inspector General asked Mr. Lundelius to lead the team investigating the SEC's failure to uncover the Madoff Ponzi scheme.

Mr. Lundelius is a Certified Public Accountant and is Accredited in Business Valuation and Certified in Financial Forensics by the American Institute of Certified Public Accountants. In addition, while a senior officer of a Financial Industry Regulatory Authority ("FINRA") broker/dealer that served as lead underwriter for securities syndications, Mr. Lundelius held a General Securities Principal license

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<sup>1</sup> SEC Enforcement Actions Addressing Misconduct That Led to or Arose From the Financial Crisis, 2/1/13, <http://www.sec.gov/spotlight/enf-actions-fc.shtml>.

(Series 24, 7 and 63) and was a Registered Investment Adviser. Mr. Lundelius calculated and evaluated broker-dealer capital adequacy under the Net Capital Rule and prepared and filed FOCUS Reports. In 1999, Mr. Lundelius was appointed by the NASDAQ Board of Directors to serve on the NASDAQ Listing Qualifications Panel, the body that reviews the listing and delisting of securities traded on The NASDAQ Stock Market.<sup>2</sup> His term ended in 2006.

Mr. Lundelius has over 30 years of experience, including 7 years in securities and investment banking in Houston and 3 years as senior vice president and chief financial officer of a life and health reinsurance carrier in Dallas. Mr. Lundelius' securities and investment banking experience includes underwriting, portfolio management, derivatives, high-yield bond and securities and commodities market analysis. He has consulted and/or testified in the areas of the underwriting process, securities market pricing, hedge fund operations, investment suitability, securities fraud, fiduciary duties, compliance and due diligence practices. He has given testimony before an administrative hearing of the SEC, in federal and state courts, at FINRA arbitrations, and before governmental hearings. Mr. Lundelius has qualified as an expert in securities trading and valuation, Investment Adviser and Investment Company Act matters, damages, financial analysis, accounting, fiduciary duties and econometrics. Also, while working for major, international accounting firms over several years, Mr. Lundelius served as an auditor of financial institutions, including broker-dealers, banks and thrifts, in the practice of public accountancy.

In his capacity as insurance company chief financial officer, Mr. Lundelius' duties included managing the company's bond investment portfolio, financial forecasting, and regulatory reporting. In addition, Mr. Lundelius' firm participated in the National Association of Insurance Commissioners' pilot study that led to the implementation of risk-based capital measurement in the insurance industry. Concurrent with his service as insurance company CFO, Mr. Lundelius was also CFO of one of the largest managing general agencies in the U.S., writing in excess of \$40,000,000 in new premium business annually, and served as trustee of the firm's self-directed 401k pension plan. Mr. Lundelius also served on the board of directors of the life and health insurance company and the boards of several insurance marketing firms. In his present role as a consultant, Mr. Lundelius has analyzed finite reinsurance issues relating to various SEC and criminal investigations.

In 2003, Mr. Lundelius authored *Financial Reporting Fraud: A Practical Guide to Detection and Internal Control*, peer-reviewed and published by the AICPA, which is currently used as a textbook in academic and professional courses. The second edition of the book was released in July, 2010.

Volunteering with not-for-profit organizations, Mr. Lundelius has served on finance and audit committees overseeing financial reporting, internal controls, investment management and policy, and operational issues. For a major Episcopal Church congregation in Washington, DC, Mr. Lundelius analyzed investment objectives and operating cash requirements to develop long-term investment policy, as well as processes to monitor performance. For another congregation, as chair of the finance

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<sup>2</sup> "NASDAQ" stands for National Association of Securities Dealers Automated Quotations.

committee, Mr. Lundelius analyzed internal controls, supervised the change in accounting systems, revised administrative and investment policies, and updated budgeting processes. Currently, under appointment by the Bishop of the Episcopal Diocese of Washington, Mr. Lundelius now serves as the Chair of the Diocesan Audit Committee, overseeing internal controls for the multi-million dollar operating budget for the diocese and its endowment funds. Mr. Lundelius also has served on the Diocesan Finance Committee and as a seminar instructor to church treasurers on Not-For-Profit accounting and internal control issues, and he has consulted with the diocese on audit and accounting issues relating to diocesan financial statements.

### **Securities, Commodity Futures and Investment Management Expertise**

In the areas of securities and commodity futures transactions, investment management and related regulatory regimes, Mr. Lundelius has:

#### *Securities Transactions and Regulation*

- On behalf of the SEC's Office of Inspector General, assisted in the investigation of the failure of the SEC to uncover the Madoff Ponzi scheme. Mr. Lundelius led a team of securities experts that interviewed SEC examinations staff and reviewed examinations work papers, policies and procedures and related documents. His work was cited by the Inspector General throughout the IG's report of investigation,<sup>3</sup> and his team issued a separate report of recommendations to improve operations at the SEC Office of Compliance Inspections and Examinations.<sup>4</sup> Mr. Lundelius supervised the analysis of purported trading volume on behalf of investors by comparison to trading reported by Bernard L Madoff Investment Securities LLC ("BMIS") to FINRA and NSCC,<sup>5</sup> as well as securities positions held at DTC,<sup>6</sup> and he developed findings relating to how the SEC could have detected Madoff's fictitious trades. Mr. Lundelius and his team also developed recommendations for improvement of SEC broker-dealer and investment adviser examinations. In his written testimony before the US Senate Committee on Banking, Housing and Urban Affairs, the Inspector General said Mr. Lundelius and his team brought

<sup>3</sup> Investigation of Failure of the SEC to Uncover Bernard Madoff's Ponzi Scheme, <http://www.sec.gov/news/studies/2009/oig-509.pdf>.

<sup>4</sup> Review and Analysis of OCIE Examinations of Bernard L. Madoff Investment Securities, LLC, <http://www.sec.gov/Reports/AuditsInspections/2009/468.pdf>.

<sup>5</sup> "NSCC" is the National Securities Clearing Corporation, a subsidiary of the Depository Trust & Clearing Corporation ("DTCC"), which provides clearing, settlement, risk management, central counterparty services and a guarantee of completion for certain transactions for virtually all broker-to-broker trades involving equities, corporate and municipal debt, American depository receipts, exchange-traded funds, and unit investment trusts.

<sup>6</sup> "DTC" is the Depository Trust Company, another subsidiary of DTCC, which effects "book-entry" changes to ownership of the securities. DTC provides securities movements for NSCC's net settlements, and settlement for institutional trades (which typically involve money and securities transfers between custodian banks and broker/dealers), as well as money market instruments.

specialized experience:

... including expertise in complex financial fraud investigations, securities-related inspections and examinations, hedge fund operations, cash flow analysis and valuations, market regulation rules, market structure issues, accounting fraud, investment suitability, the underwriting process and compliance and due diligence practices.<sup>7</sup>

- With regard to investment advisers who recommended investments in Madoff funds, was qualified as an expert in investment adviser due diligence and testified in multiple arbitrations on the fiduciary duties of advisers.
- On behalf of KPMG LLP, was qualified in arbitration as an expert in auditing standards, investment fund operations and forensic accounting. Mr. Lundelius testified regarding the legitimate and illegitimate operations of BMIS and the presumed findings of auditors had those auditors performed extended procedures at BMIS as a service organization during the audits of funds that invested with Madoff.
- On behalf of PricewaterhouseCoopers Canada and PricewaterhouseCoopers Netherlands, testified regarding auditing standards under both US Generally Accepted Auditing Standards ("US GAAS")<sup>8</sup> and International Standards on Auditing ("ISA")<sup>9</sup> relating to audits of funds that invested with BMIS. Areas of testimony included the regulatory framework for broker-dealers and investment advisers, the auditors' role related to internal controls, and how the Madoff fraud was perpetrated.
- On behalf of a major California-based financial institution, analyzed the operations of a broker-dealer subsidiary of a bank holding company with regard to sale of Structured Investment Vehicle (SIV-lite) Asset Backed Commercial Paper to an insurance company. Analysis included a detailed evaluation of the capital structure and vintages of the SIV-lite as well as liquidation and wind-down procedures, evaluations by Nationally Recognized Statistical Rating Organizations, and broker due diligence procedures. With regard to suitability, analysis included evaluations under the Exchange Act of 1934, Investment Advisers Act of 1940, Federal Reserve Board Regulation R, FINRA regulations and California Insurance Code requirements.
- On behalf of regional wirehouse firms, assessed validity of short positions taken in the process of underwriting Private Investment in Public Equity Securities ("PIPEs") offerings. Analyses included compliance with short selling rules prior to PIPEs issuance, liquidity of PIPEs markets, and valuation of related securities.
- On another PIPEs matter in which the SEC alleged inflated share prices created excess

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<sup>7</sup> Written Testimony of H. David Kotz, Inspector General of the Securities and Exchange Commission, Before the US Senate Committee on Banking, Housing and Urban Affairs, September 10, 2009.

<sup>8</sup> Generally Accepted Auditing Standards in the United States are promulgated by the Public Company Accounting Oversight Board for SEC registrants and by the Auditing Standards Board of the AICPA for non-registrants.

<sup>9</sup> International Standards on Auditing are issued by the International Auditing and Assurance Standards Board.

compensation for an investment manager, evaluated the impact of PIPE offerings and equity lines of credit on issuer stock price, Rule 144 considerations, and valuations of securities issued.

- While serving on the NASDAQ Listing Qualifications Panel, evaluated multiple financing proposals by listed firms attempting to increase capital utilizing PIPEs, equity lines of credit, and similar vehicles.
- Testified at NASD<sup>10</sup> enforcement proceeding regarding commissions on and allocations of Hot IPO<sup>11</sup> shares brought by NASD Department of Enforcement (DOE) against Ken Langone's broker-dealer, Invemed Associates, with regard to Rule 17a-5 broker accounting and books and records requirements. Mr. Lundelius' testimony included opinions on US GAAP, US GAAS, and SEC rules and staff accounting bulletins dealing with revenue recognition and financial statement presentation. Mr. Lundelius also analyzed the impact of DOE's enforcement positions on aspects of the underwriting process such as commission rate structures and the distribution of securities to hedge funds and small investors. NASD Panel returned a decision in favor of Mr. Langone. In an unrelated matter, the Supreme Court of the United States cited the *Invemed* decision with regard to reasonableness of securities fees and commissions from customers who received Hot IPO allocations.<sup>12</sup>
- On behalf of an individual investor in a FINRA arbitration, prepared analysis of risk exposure due to portfolio concentrations in limited number of securities using margin debt. Case was successfully settled.
- On behalf of a broker-dealer, analyzed churning claims by investor who aggressively traded in his account, with turnover in excess of 24:1, while maintaining numerous other accounts at other firms which had little turnover. Case was successfully settled.
- At arbitration, testified as to propriety of closing trading windows for corporate insiders and the impact on stock price, using share-trading models, had the windows remained open for an executive wishing to exercise stock options; in addition, analyzed damages using Black-Scholes, variable prepaid forward and share valuation models.
- On behalf of an executive of a major equipment supplier to the gaming industry accused of insider trading by the SEC, prepared an analysis of business plans and public disclosures, as well as published analysts' reports, to determine if inside information was public. In addition, Mr. Lundelius analyzed market efficiency of the gambling company stock by use of an event

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<sup>10</sup> The National Association of Securities Dealers, Inc. ("NASD") was the predecessor self regulatory organization to FINRA.

<sup>11</sup> An IPO is a corporation's first offering of stock to the public. A hot IPO or hot issue is one in which the stock immediately trades at a premium in the aftermarket because there is greater public demand for the stock than there are available shares.

<sup>12</sup> *Credit Suisse Securities (USA) LLC FKA Credit Suisse First Boston LLC, et al. v. Glen Billig, et al.*, 551 U.S. 264 (2007).

study and other metrics, including those metrics established by his testimony in prior cases. Business plan analysis included assessment of operations and opportunities in the Las Vegas and Macau markets, the latter involving significant evaluation of Asian gambling practices and patterns.

- In federal district court, qualified as an expert in accounting relating to auditing and accounting for share-based payments in a stock option backdating claim brought against the former CFO of Maxim Integrated. Mr. Lundelius opined on documentation standards under US GAAS and accounting for options under US GAAP, including valuation.
- Assisted New York Stock Exchange specialist firms Van Der Moolen and LaBranch with interpretation of Exchange Rules during the Exchange's investigation of specialist interpositioning and best execution violations. Engagements included analysis of trading systems and matching alleged violations identified by the Exchange with trade records from the specialists, examining for evidence of front-running and latency of trade execution. Scope of the engagements involved millions of trades.
- Consulted for defendants in a criminal action brought by the New York Attorney General against a securities broker and a promoter charged with selling fraudulent and unsuitable investments. On separate matters brought by the Manhattan District Attorney's office and the Office of the U.S. Attorney, consulted on IPO share allocations, marking the close and no-net-sales issues relating to brokers charged with stock manipulation and "pump and dump" schemes.

#### *Commodity Futures Trading and Regulation*

- On behalf of the National Futures Association ("NFA"), led the investigation of the failure of NFA auditors to detect fraud at Peregrine Financial Group, Inc. The investigation analyzed audit standards and the regulatory and operational aspects of future commission merchants, especially United States Commodity Futures Trading Commission ("CFTC") Regulations 1.14, 1.15 for risk assessment, CFTC Regulations 1.20, 1.25 and 30.7 for segregated and secured funds and CFTC Regulation 1.17 for net capital. The investigation also included examination of NFA and Joint Audit Committee<sup>13</sup> procedures. The investigation produced a report of findings<sup>14</sup> and a report of recommendations<sup>15</sup> for NFA.
- On behalf of a major investment bank, determined the compliance of a major futures commission merchant with accounting and valuation covenants in credit facilities. Analysis

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<sup>13</sup> The Joint Audit Committee is a representative committee of the audit and financial surveillance departments of U.S. futures exchanges and regulatory organizations, including representatives of the NFA and other self-regulatory organizations as well as representatives of the CFTC.

<sup>14</sup> Report of Investigation: Analysis of the National Futures Association's Audits of Peregrine Financial Group, Inc., [http://www.nfa.futures.org/news/BRG/report\\_of\\_investigation.pdf](http://www.nfa.futures.org/news/BRG/report_of_investigation.pdf) .

<sup>15</sup> Recommendations Report: Analysis of the National Futures Association's Audits of Peregrine Financial Group, Inc., [http://www.nfa.futures.org/news/BRG/final\\_recommendations\\_report.pdf](http://www.nfa.futures.org/news/BRG/final_recommendations_report.pdf) .

included assessment of CFTC and NFA regulatory requirements, applicable US GAAP standards,<sup>16</sup> and reporting requirements. Commodities trading separate accounts and investments in commercial paper and futures positions were also assessed, as well as operations of a related global investment fund.

- Relating to a separate futures commission merchant, analyzed the corporate governance and financial reporting for offshore commodities pools, including trading operations, position management and reporting. Mr. Lundelius consulted on third party administrator functions and duties for hedge funds, especially for foreign funds based in the Cayman Islands.
- On behalf of a futures commission merchant subject to CFTC Order, served as independent third party reviewer to assess measures implemented to correct CFTC findings of inadequate supervisory procedures (Regulation 166.3) and inadequate credit and concentration risk policies and controls. Analyses consisted of detailed examinations of position limits and credit limits and the operation of related controls.

#### *Investment Management and Regulation*

- On behalf of the US Department of the Interior, analyzed investment practices relating to funds held in trust for Indian Nations, including adequacy of documentation, suitability of investments, and adherence to the Prudent Investor Act. Mr. Lundelius was qualified in Federal Claims Court as an expert in prudence of trust fund investments, accounting and auditing of trusts, fiduciary duties and trust fund management.
- On behalf of The Reserve Fund (\$3T AUM), as part of settlement negotiations with the SEC, prepared a comprehensive cost allocation study to assess the profitability of the investment adviser and related distribution and management entities within the fund complex. In an action brought by the SEC, Mr. Lundelius testified as to damages incurred when The Reserve Fund broke the buck in September, 2008, including assessment of investor earnings and asset recoveries. In a ruling on motions in that case, Judge Gardephe stated that Mr. Lundelius was “qualified by training and experience” to offer opinions and that he considered Mr. Lundelius’ report “in connection with the parties’ arguments about the disgorgement remedy sought in the complaint”.<sup>17</sup>
- On behalf of a pension plan, assessed the development of investment recommendations by a major registered investment adviser, including application of ERISA standards, relating to an index arbitrage strategy utilizing an unaudited intermediary. Mr. Lundelius analyzed operational due diligence performed by the adviser as well as subsequent correspondence between the

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<sup>16</sup> “US GAAP” are the Generally Accepted Accounting Principles for the United States promulgated by the Financial Accounting Standards Board.

<sup>17</sup> Transcript of proceedings in United States District Court, Southern District of New York, before Hon. Paul G. Gardephe, March 28, 2012.

adviser and the SEC and US Department of Labor.

- At a criminal trial in US District Court, was qualified as an expert in accounting, pension plans and business valuation and testified on regulations relating to operations of registered investment advisers with regard to underwritings by affiliates and the related securities and ERISA requirements for pension fund clients, including SEC and US Department of Labor rulings. Testimony also included assessment of internal controls and financial and securities reporting requirements under both the Investment Company Act and the Investment Advisers Act of 1940.
- On behalf of a \$7 billion AUM investment adviser and under order from the SEC<sup>18</sup> as SEC-approved Independent Consultant to examine compliance with Sections 204(a), 206(2) and 206(4) of the Investment Advisers Act of 1940 and Rules 204-2(a)(12), 206(4)-2(a) and 206(4)-(7) thereunder, reviewed:
  - Internal controls over financial reporting
  - Best execution, trade allocation and compliance reporting
  - Investor reporting, accuracy of answers to due diligence questionnaires, and timeliness of fund audits
  - Trade monitoring, risk exposure, and controls over use of inside information, cherry-picking, and front-running
  - Segregation of duties and functions for related broker-dealer
  - Compliance policies and procedures, including Rule 206(4)-(7) reporting

Additional work was performed to determine if there was evidence of insider trading during the period from 2006 – 2008 and to analyze the controls over insider trading. In addition, pursuant to review of Rule 206(4)-(7), the SEC required assessment of policies and procedures for all issues listed above as well as progress reports on the implementation of remediation to any deficiencies. Two reports were filed with the SEC's Enforcement Division in Los Angeles. In addition, Mr. Lundelius held face-to-face meetings with compliance personnel of major brokerages whose customers invested with the investment adviser regarding the impact of the SEC Order, investment manager changes and controls improvements.

- Analyzed portfolio investments, on behalf of a pension plan, for lack of diversification under ERISA as alleged by Department of Labor, incorporating portfolio research findings on time diversification of money with Prudent Investor standards. DOL settled under favorable terms after Mr. Lundelius' presentation of findings to opposing counsel in the Office of Solicitor.
- On behalf of pension fund customer, reviewed broker/dealer due diligence procedures for real estate direct participation programs and suitability of those programs for pension fund investment, analyzing asset allocation and fund investment policies and valuing the investment interests in each real estate entity. Case was successfully settled.
- At FINRA arbitration, testified, as an expert on corporate governance and fiduciary standards,

<sup>18</sup> <https://www.sec.gov/litigation/admin/2011/34-64442.pdf>.

on behalf of Charles Schwab & Co. regarding the appropriate governance structure and board fiduciary duties with respect to investment selection and monitoring by a not-for-profit entity.

- On behalf of a registered investment adviser, testified at trial in California State Court on portfolio management, fiduciary duties, and damages relating to a long/short strategy fund. Jury returned a favorable verdict.
- In connection with regulatory investigations of research published by securities analysts, evaluated the discounted cash flow and working capital forecasts, including estimates of liquidity, earnings multiples and future funding needs, made by a Salomon Smith Barney analyst, working with Jack Grubman, for telecommunications securities, including equities and distressed high yield bonds, covered by SSB in connection with an NASD arbitration proceeding.
- In connection with a large internal investigation, analyzed derivatives transactions and financial models of Freddie Mac, a major originator of mortgage bond structured securitizations and a primary dealer in treasury bonds utilizing one of the most comprehensive hedging operations in the financial services industry. Areas of investigation included extensive interviews of trading and accounting personnel, evaluation of accounting issues, assessment of bond trading systems, financial analysis of derivative transactions (impact on duration, convexity and swaption valuation using Black-Scholes), ASC 320 - *Investments* classification, and determination of economic rationale for transactions.<sup>19</sup> As part of this analysis, Mr. Lundelius also extensively reviewed and recomputed Value at Risk measurements incorporating findings from the internal investigation.
- Analyzed insider trading activities of Section 16 officers in class action and criminal prosecution matters, including valuation of vested and non-vested options, interaction with short-swing profit rule, tax implications, and SEC Rule 144 and other restrictions.
- On behalf of Lucent, analyzed damages alleged by seller due to decline in Lucent stock received as payment for firm acquired by Lucent. Damages analysis included ability of seller to hedge by use of option, costless collar, variable prepaid forward or other strategies.
- Analyzed complex derivative transactions (including Black-Scholes and Convenience Yield analyses) intended as cash flow hedges for energy commitments made by major utilities with regard to an earnings restatement and an SEC investigation. In addition, while employed by a major accounting firm, advised auditors of an international electric power company on accounting issues.
- Analyzed auditing and disclosure of derivative transactions of Safety-Kleen, a major landfill and waste disposal firm, including assessment of accounting treatment of swaptions and other

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<sup>19</sup> "ASC" refers to the Accounting Standards Codification implemented in the United States by the Financial Accounting Standards Board in 2009. References to pre-codification financial accounting standards in this *curriculum vitae* have been updated to current ASC references.

instruments.

- In administrative hearing before the SEC, designed and testified regarding econometric models to determine the impact of securities trading under various market conditions, modeling securities price valuation, event analysis, the impact of institutional investor trading and the role of transfer agents. In her opinion, SEC Administrative Law Judge Foelak referenced the modeling methodology and cited extensively from Mr. Lundelius' testimony regarding his assessment of the actions that would have been taken by an "economically rational shareholder".<sup>20</sup> At the hearing, Mr. Lundelius was qualified as an expert in securities valuation and as an expert in the price behavior of securities sold into thinly traded markets.
- In testimony in federal district court in Florida, refuted stock manipulation charges by SEC through analysis of the stock's illiquid market and share price movements at the time the issuer and promoters made news announcements. Mr. Lundelius discussed measures of random walk, such as Augmented Dickey Fuller tests, bid-ask spread, and stock price reaction to news entering the market. In his opinion, Senior Judge Gonzalez cited numerous statistics from Mr. Lundelius' testimony and report.<sup>21</sup>
- In a similar case brought by the SEC in federal district court in Connecticut against a public company and brokers trading its stock, testified for defendants about specific alleged matched trades and market maker quotes preceding those trades. The jury deadlocked on some counts but found for defendants on all others. In a retrial at which Mr. Lundelius testified on quote spreads and ability to "mark the close", the jury found for the defendant stock broker. Testimony in both cases included market efficiency analyses as demonstrated by Augmented Dickey Fuller tests of random walk and other measures of efficiency. Testimony in both Florida and Connecticut district courts, as well as subsequent case history, expanded the list of factors to consider when determining whether a security trades in an illiquid market.<sup>22</sup>
- Further to stock manipulation claims relating to the 2010 Flash Crash, advised high frequency traders on issues relating to regulation, policy and economic issues.
- On behalf of several high net worth investors, investigated misuse of insurance products, SEC Rule 144 offerings and master limited partnerships by family office operations at Merrill Lynch, Morgan Stanley, and major bank trust companies. Mr. Lundelius' engagements included the suitability of these products, including product liquidity and pricing. Estate planning was a significant issue in each case, involving the use of grantor trusts, charitable remainder trusts and other estate planning vehicles.

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<sup>20</sup> Judge Foelak's opinion is available through the SEC's web site at <http://www.sec.gov/litigation/aljdec/id173cff.htm> .

<sup>21</sup> *Securities and Exchange Commission v. David Gane, et al.*, 2005 U.S. Dist. LEXIS 607; 18 Fla. L. Weekly Fed. D 401, at 35-37.

<sup>22</sup> A list of factors to consider to determine whether a security traded in an inefficient or illiquid market were developed in *Rose CAMMER, et al., v. Bruce M. BLOOM, et al.*, U.S.D.C. New Jersey, 711 F.Supp. 1264 (1989), also known as the "Cammer Factors".

- For an ultra-short mutual fund, provided opinions regarding the industry practice and regulatory framework for a mutual funds' communications with the public, and the process by which communications with the public are created, reviewed, and approved.<sup>23</sup> Also, Mr. Lundelius analyzed risk-return characteristics of structured finance products in the portfolio and assessed liquidity and the impact of redemptions on net asset value ("NAV").
- On behalf of a mutual fund president, filed an affidavit based on analysis of market timing transactions, disclosure of constraints on those transactions and the impact they had on fund operations. Analyzed fund Class A, B and C share issues, including impact on investment performance.
- On behalf of a major mutual fund sponsor and administrator, reviewed fee structure and operational controls, including NAV calculations and sales charges for the fund complex.
- On behalf of another mutual fund, consulted on NAV calculations relating to valuation and accounting issues.
- On behalf of UBS PaineWebber, testified at NASD arbitration regarding a novel concept of broker liability for allegedly recommending the wrong type of investment adviser for a wrap account, opining on classifications of investment styles used by funds managers. NASD panel found in favor of UBS.

#### *Internal Controls and Supervisory Procedures*

- On behalf of the former COO of Countrywide Financial Corporation, analyzed the internal control structure at Countrywide, including specific audit, credit and loan loss committees at both the management and board levels, and assessed compliance with the COSO<sup>24</sup> *Internal Control - Integrated Framework* and Auditing Standards 2 and 5. In two separate reports, Mr. Lundelius analyzed the due diligence process for mortgage loan securitization at Countrywide. All reports assessed whether the COO could have reasonably relied upon corporate internal controls for the information received.
- On behalf of Hank Greenberg and Howie Smith, analyzed the internal controls and assessed compliance with the COSO *Internal Control - Integrated Framework* at American International Group relating to reinsurance treaties and consolidation of special purpose entities. The assessment included analysis of transfer of risk, the development of accounting guidance relating to SPEs from 1990 – 2002, and review of the organizational and reporting structure at AIG.
- On behalf of a major California-based financial institution, analyzed the operations of a broker-

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<sup>23</sup> *Securities and Exchange Commission v. Kimon P. Daifotis, et al.*, U.S. Dist., ND Ca., No. C 11-00137 WHA, Order Granting In Part and Denying In Part Motion to Exclude Expert Opinion of Charles R. Lundelius, June 7, 2012.

<sup>24</sup> "COSO" stands for Committee of Sponsoring Organizations of the Treadway Commission.

dealer subsidiary of a bank holding company, including supervision of the processes used by registered representatives to assess investment suitability. Mr. Lundelius also analyzed the intersection of banking and broker-dealer regulations, particularly Federal Reserve Board Regulation R and FINRA regulations.

- On behalf of an individual customer, testified on supervisory procedures relating to registered representative/insurance salesman who misappropriated customer funds while cashing out various insurance policies, opining on the intersection of insurance and securities regulations relating to supervision.
- On behalf of a senior vice president of a regional broker/dealer, opined at NASD arbitration on turnover calculations used to determine churning of investor accounts.
- Testified for and consulted with investor/plaintiffs at NASD arbitration regarding stock trading manipulation scheme, broker/dealer compliance and supervisory procedures, and damages to investors, including ability to trade in a thin market and the value of shares sold into that market.
- Consulted with hedge funds and prime brokers regarding accounting policies, trading controls, personnel changes, risk management and due diligence procedures. Work in this field has included detection and assessment of inappropriate investment strategies ("style drift") as well as establishing monitoring controls over short selling, margin accounts and risk exposure.

#### *Real Estate Investment Trusts*

- On behalf of a nine billion dollar hedge fund, constructed the accounting systems, procedures and policies for the initial public offering ("IPO") of a Real Estate Investment Trust ("REIT"), including internal controls and valuation mechanisms.
- In a FINRA Department of Enforcement action, on behalf of a leading broker-dealer marketer of non-listed public REITs, analyzed the suitability of the REIT offerings, valuation of the REIT units transacted in tertiary markets and appropriate disclosures of REIT unit values and performance in customer account statements. Analysis included review of filings with FINRA Corporate Financing Department and analysis of communications with the public and reasonable basis suitability standards.

#### *Hedge Funds and Private Equity*

- With regard to the debt and equity structure of a hedge fund, reviewed financial reporting and internal accounting records to determine treatment of subordinated debt of Bermuda and Cayman feeder investors. Mr. Lundelius also assessed accounting for redemption requests and fund leverage, as well as the calculations of fees and profit sharing.
- On behalf of a major hedge fund administrator, opined on the appropriate treatment of

redemption requests under US GAAP at the master and feeder fund levels, in particular, ASC 480 - *Distinguishing Liabilities from Equity*. Mr. Lundelius assessed the role of a hedge fund administrator and its calculation of net asset values for fund investors.

- At an international arbitration, assessed fiduciary duties of investment advisers to clients invested in proprietary hedge funds, including reporting and governance standards of Cayman Islands and Switzerland. Issues also included portfolio management and suitability of recommendations.
- On behalf of a major business development corporation, assessed SEC claims of improper valuations of early stage portfolio companies. Analysis included assessment of bankruptcy probabilities, valuation models and financial disclosures, as well as fair value standards under US Private Equity Valuation Guidelines and US GAAP.
- On behalf of investors in private equity funds invested in Special Purpose Vehicles registered in the British Virgin Islands, analyzed the investment presentations and due diligence standards for portfolios of life settlement contracts and other assets to assess breaches of fiduciary duties of the managing director and chief investment officer.
- On behalf of CIBC Oppenheimer, testified at NASD arbitration as to the impact actions taken by a hedge fund's prime broker had on portfolio performance, including analysis of margin calls and the effect of share dispositions in thinly traded markets, as well as damages calculations.

#### *Securities Class Actions*

- Investigated accounting issues related to the bankruptcy of Global Crossing on behalf of the Special Committee of the Board of Directors, specifically reviewing fair values and revenue recognition of asset exchanges, classification of operating vs. capital (or sales-type) leases, and impact on financial reporting and debt covenants.
- On behalf of a corporate defendant, analyzed the validity of management and analysts' forecasts and their impact on the value of stock prices for \$150 million securities fraud class action suit, including analysis of accounting and sales data, revenue recognition issues, and determining when management became aware of certain information. Due to findings on accounting issues, Judge Hilton (E.D. Va.) dismissed all accounting claims prior to trial and found for defendants immediately after plaintiffs presented their case.

#### **Valuation and Investment Banking Expertise**

With regard to valuation, due diligence and investment banking, Mr. Lundelius has:

### *Securities Valuations*

- With regard to a hedge fund investing in small capitalization stocks, assessed market liquidity of convertible securities, including assessment of investment banking functions performed by affiliates of the hedge fund manager. Mr. Lundelius also opined on valuations of securities and determined whether markets for those securities were active in accordance with *ASC 820 - Fair Value Measurement*.
- Consulted with publicly traded and privately held institutional investors on valuation of and accounting for auction-rate securities, mortgage-backed securities, credit default swaps and other alternative investment products, including analysis of market liquidity and impact of that liquidity on fair value under IFRS,<sup>25</sup> US GAAP and insurance Statutory Accounting Practices. Drawing upon federal district court decisions, including those cases in which Mr. Lundelius testified, Mr. Lundelius was able to establish whether the markets were active and allowed for orderly transactions.
- On behalf of a US affiliate of a major European insurance carrier, evaluated accounting for investments and management stock options under IAS 39 and 40 and IFRS 2.
- On behalf of two major European insurance carriers, evaluated investment classifications under IAS 32, 39 and 40 and IFRS 7. Additionally, Mr. Lundelius analyzed insurance risks under IFRS 4 for reinsurance contracts and ceding agreements.
- On behalf of Hank Greenberg and Howie Smith, valued the investment made by an affiliate of American International Group in a special purpose entity. Analysis included assessment of loss development for the book of business ceded to the SPE as well as application of accounting rules for other than temporary impairment in accordance with *ASC 320-10-35 - Investments – Debt and Equity Securities*.
- Consulted with institutional investors on valuation of auction-rate securities, mortgage-backed securities, credit default swaps and other alternative investment products, including analysis of market liquidity and impact of that liquidity on fair value.
- Testified at FINRA hearing on damages relating to alleged raiding of high-yield securities trading unit of publicly traded broker-dealer, including determination of value of entire unit and value of registered representatives and other personnel using both market comparables and discounted cash flow methodologies.
- Valued multi-office broker-dealers and individual branch offices of AG Edwards and Advest regarding alleged raiding of registered representatives. Valuation included alleged loss of investment advisory clients and confidential information resulting from alleged interference in broker employment agreements.

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<sup>25</sup> "IFRS" are the International Financial Reporting Standards promulgated by the International Accounting Standards Board.

- Valued and testified regarding multiple-representative day-trading operations within E\*Trade in NASD arbitration. In a separate matter, valued a day-trading unit within E\*Trade relating to alleged improper contract termination. Valuation also addressed alleged loss of reputation due to the contract termination.
- Valued investment advisory unit of regional broker-dealer in alleged client theft matter. Assets valued included alleged loss of client lists, trade secrets and other confidential information resulting from alleged interference by investment managers that organized the departure of key investment advisory personnel.
- Analyzed and valued electronic bond trading systems for antitrust claim, including the role of institutional investors, dealers and brokers in the trading of fixed income investments.

#### *Securities Due Diligence*

- On behalf of an individual investor, investigated the failure of a registered investment adviser to perform adequate due diligence relating to investments in a Ponzi scheme, including failure to register as a broker-dealer and failure to report payments from Ponzi scheme promoters.
- Consulted with hedge funds of funds regarding due diligence procedures for prospective fund managers.
- On behalf of CIBC Oppenheimer, testified at NASD arbitration on investment due diligence procedures utilized to screen and monitor hedge funds, including development of relevant NASD standards and analysis of files, personnel testimony, emails and memoranda.
- Testified in Florida State Court on investment due diligence procedures and findings relating to capital financing of a property and casualty insurance carrier, including statutory accounting financial forecasts, surplus deficiencies and regulatory constraints. Mr. Lundelius was qualified as an expert in insurance company financing and acquisition due diligence.
- As an investment banker, structured underwritings of securities offerings for Blockbuster and Precision Tune franchises, including development of accounting and cash flow forecasts, review of franchise agreements and assessments of markets to value financial interests sold to investors.
- As basis for other investment banking underwritings, valued numerous businesses and business units in the following fields: biotechnology and medical diagnostics, real estate, oil & gas, environmental remediation, wholesale and retail distribution of consumer products, office and industrial construction, automotive and motorcycle dealerships, and service firms. Investment vehicles utilized included public offerings, private placements and master limited partnerships.
- Performed due diligence investigations of direct investment programs involving real estate, oil &

gas, food processing, biotechnology and medical diagnostics for a major wirehouse and other broker/dealer clients and valued restricted stock and illiquid debt and equity investments related to those programs.

#### *Other Due Diligence and Valuation Matters*

- Testified in Florida state court as an expert in post-acquisition disputes regarding alleged fraud in financial reporting of the purchase of a manufacturing division by a Tier One automotive manufacturer and supplier. Analysis involved extensive investigation of accounting reserves (ASC 450 – *Contingencies*) for acquisitions made by the seller to allegedly hide losses as well as quantification of damages due to alleged underperformance hidden by fraudulent accounting.
- Testified in federal district court as damages expert in copyright infringement suit against publisher on issues involving marketing of copyright matter, direct mail advertising, and profitability.
- Testified in federal bankruptcy court regarding the allocation of purchase price to intellectual property and goodwill for assets sold by debtor, a software developer of supply chain management systems.
- On behalf of a municipality, analyzed damages from alleged government interference in debt collection efforts by a major operator of health and fitness centers. On behalf of a major fitness celebrity, determined damages due to alleged breach of contract by a national chain of diet centers.
- On behalf of a student loan origination firm, calculated damages due to alleged servicing failures, including debt collection operations. On behalf of a regional bank, assessed damages due to alleged servicing failures on multiple consumer loan portfolios. For both engagements, portfolios of student and consumer loans aggregated to more than \$800,000,000. In a separate matter, after the collapse of a student loan originator, analyzed liability and damages relating to securitizations with over \$400,000,000 of loan pools.
- On behalf of a regional bank, assessed dealer reserve chargebacks due to loan chargeoffs for a mortgage loan originator. Work involved evaluating minimum reserves required and performance of loans assigned to the bank.
- On behalf of Resolution Trust Corporation, documented fraudulent lending within real estate mortgage portfolio of failed thrift, analyzing failures to follow lending policies and procedures.
- On behalf of major sports stadium association, performed due diligence and valuation of multiple hotel properties, including franchises and luxury properties.
- Valued biotechnology patent utilizing offers in restricted stock from various early-stage biotechnology firms.

- Applied Capital Asset Pricing Model to intellectual property litigation for a \$60 million polyethylene process patent claim asserted by one Fortune 50 company against two other Fortune 50 companies, including regression analyses of intermediate product values, and determined the basis for an antitrust counterclaim.
- Valued semiconductor technology, including forecasts of product development life cycles and performed R&D cost analyses for patent infringement claim by a European information technology firm against a supplier to major automotive manufacturers.
- Served as expert witness on behalf of a software development firm to assess damages, determine counterclaim under software licensing agreement and value software in suit filed by a nationwide provider of multiple listing services to real estate agents.
- Testified in federal district court on behalf of multinational food processing and distribution firm regarding damages resulting from alleged breach of exclusive territory agreement with distributor.

### Insurance Expertise

When numerous investigations by US and foreign regulators focused on finite reinsurance treaties, bid rigging and other insurance issues, Mr. Lundelius was called upon to assist in the analysis of auditing issues, risk transfer, adequacy of premium and internal controls. In the course of serving on several investigations, both in the US and in Europe, Mr. Lundelius has reviewed hundreds of reinsurance treaties in both the property and casualty and life and health segments covering workers compensation, life, casualty and other risks worldwide.

Among his specific engagements, Mr. Lundelius:

- On behalf of Hank Greenberg and Howie Smith, analyzed the internal controls and assessed compliance with the COSO *Internal Control - Integrated Framework* at American International Group relating to reinsurance treaties and consolidation of special purpose entities. The assessment included analysis of transfer of risk, including ASC 450 – *Contingencies* and ASC 944-20-05 - *Reinsurance* and SSAP 62R - *Property and Casualty Reinsurance*.<sup>26</sup> Analysis also included review of loss development and disclosures in AIG affiliate property and casualty statutory filings, especially Schedule P.
- On behalf of a major, publicly traded European insurance carrier, analyzed the claims made by an internal auditor whistleblower relating to hedging and segregation of duties. Analysis included assessment of macro-hedging strategy and internal control requirements under the

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<sup>26</sup> An "SSAP" is a Statement of Statutory Accounting Principles for insurance companies domiciled or licensed in the United States. Statutory Accounting Principles ("SAP") are the primary authoritative statutory accounting practices and procedures promulgated by the National Association of Insurance Commissioners in the United States.

COSO *Internal Control - Integrated Framework* and Auditing Standard 5. In addition, Mr. Lundelius reviewed actuarial analyses, financial statements prepared under US GAAP and IFRS, and filings with US Department of Labor and the UK Prudential Regulatory Authority.

- On behalf of a major California-based financial institution, analyzed the operations of a broker-dealer subsidiary with regard to sale of Structured Investment Vehicle (SIV-lite) Asset Backed Commercial Paper to an insurance company. With regard to suitability, analysis included evaluation of California Insurance Code restrictions on investments and requirements for investment approval, as well as assessment of Risk-Based Capital and other insurance reporting issues.
- On behalf of a regional financial institution, testified, in Florida State Court, on investment due diligence procedures and findings relating to capital financing of a property and casualty insurance carrier that the Florida Department of Insurance claimed could have been rehabilitated. Mr. Lundelius reviewed statutory accounting financial forecasts, underwriting practices, forecast surplus deficiencies and assessed regulatory constraints. Mr. Lundelius was qualified as an expert in insurance company financing and acquisition due diligence.
- On behalf of a regional accounting firm, testified, in Texas State Court, regarding auditing and accounting issues relating to a workers' compensation carrier that the Oklahoma Insurance Department claimed was insolvent. Mr. Lundelius analyzed audit work papers and programs, underwriting and case reserve practices, reinsurance and regulatory examinations. Mr. Lundelius was qualified as an expert in auditing and forensic accounting, and his testimony also covered damages as a result of deepening insolvency involving valuation of the carrier on various dates.
- Consulted with a major health insurance company licensed in all US jurisdictions regarding prompt-pay requirements, including detailed analysis of underwriting, claims operations and reserves. Analyses also covered financial reporting and disclosures in SEC filings and discussions with insurance regulators.
- Was retained as an expert in reinsurance and solvency issues related to the collapse of Reliance Insurance, a major workers compensation property and casualty carrier that was the subject of a criminal investigation. As part of his work, he analyzed statutory and GAAP financial statements and assessed issues related to auditing, internal controls, accounting for reinsurance treaties and deposits, including *ASC 944-20-05 - Reinsurance* and *SSAP 62R - Property and Casualty Reinsurance*, and analyzed changes to risk based capital.
- Has consulted on the structuring of finite reinsurance contracts and has been engaged by major US and European carriers to assess finite reinsurance arrangements, related to various SEC and regulatory investigations, involving US GAAP and SAP, foreign GAAP (Bermuda, France, Ireland, UK and Switzerland) and International Financial Reporting Standards. His work has included conducting internal investigations of treaty negotiations with insurance brokers and

counterparties, risk transfer analyses among captives and affiliates, and assessment of auditing and accounting practices and associated internal controls, including *SSAP 61 - Life, Deposit-Type and Accident and Health Reinsurance* and *SSAP 62R - Property and Casualty Reinsurance*, as well as *ASC 944-20-05 -Reinsurance* and *IFRS 4 - Insurance Contracts*.

- Advised on restructuring of bank credit facilities for major reinsurer and its offshore special purpose reserve credit trusts for Regulation XXX, including review of *ASC 825 - Financial Instruments* and *SSAP 27 - Disclosure of Information about Financial Instruments* disclosures. Analysis involved assessment of subprime and other illiquid instruments and determination of market values under both GAAP and SAP.
- Advised on strategic decisions relating to runoff for a \$13 billion life and health reinsurer, including assessment of regulatory restrictions imposed by US, Bermudan, Irish, British and Cayman regulators, liquidity and cash flow forecasting, and US risk-based capital requirements and related capital requirements in foreign jurisdictions. The engagement also involved extensive analysis of special purpose vehicles, including *ASC 810-10 - Consolidation – Variable Interest Entities* and *ASC 860 - Transfers and Servicing* issues, as well as *ASC 825 - Financial Instruments* and related *SSAP 27 - Disclosure of Information about Financial Instruments*.
- With regard to life settlement acquisitions by a major insurance carrier from an industry leading originator, evaluated transfer of risk with regard to Lender Protection Insurance Coverage (“LPIC”). The evaluation included analysis of LPIC claims history, *ASC 450 – Contingencies*, and related salvage and subrogation issues.
- On behalf of a major property and casualty insurance carrier’s US operations, consulted on bid rigging and market conduct investigations by numerous state insurance commissions.
- With regard to sales of insurance products to wealthy families, has determined suitability relative to alternative investments.
- On behalf of major health insurer, consulted on unlocking of *ASC 944-20 -Insurance Activities* reserves, including discussions with SEC staff, and advised on *ASC 825 - Financial Instruments* and *SSAP 27 - Disclosure of Information about Financial Instruments* issues.
- On behalf of a major health insurance carrier, analyzed classifications and disclosures of investments under *SSAP 27 - Disclosure of Information about Financial Instruments* and directed negotiations with NAIC SVO<sup>27</sup> on re-classification of securities.
- Has conducted internal investigations of corporate officers relating to existence of reinsurance side agreements, documentation of risk transfer analyses, and violations of auditing standards and internal controls.

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<sup>27</sup> “NAIC SVO” is the Securities Valuation Office of the National Association of Securities Commissioners in the United States.

Previously, Mr. Lundelius served as CFO of a life and health insurance carrier that reinsured books of business placed with major insurance companies. As CFO, the scope of duties Mr. Lundelius performed included the following:

- Valuation of books of business and insurance company operating units for purposes of financial reporting and capital acquisition.
- Negotiation of reinsurance treaties and surplus debenture financing.
- Management of variable life and annuity investment products through captive sales force.
- Development of integrated financial and regulatory forecasting systems, including re-scoping of general ledger and chart of accounts.
- Management of and financial reporting for government bond investment portfolio.
- Participation in the NAIC pilot study for implementation of risk-based capital adequacy standards.
- Implementation of product line profitability reporting systems.
- Design of hierarchical agent commission and debit advance systems.
- Discussions with auditors and SEC regarding applications of GAAP, including ASC 450 – *Contingencies*, ASC 944-20 - *Insurance Activities*, especially ASC 944-20-05 - *Long Duration Contracts and Reinsurance*.
- Managing the audit process, internal audit and auditor inquiries.
- Translation of actuarial data and projections into financial and regulatory formats.
- Interaction with regulators, investment bankers and commercial lenders.
- Financial management of underwriting and claims functions.

### **Publications and Selected Speeches**

- “SEC’s Expanded Use of Administrative Proceedings: How an Expert Can Help”, *Westlaw Journal Derivatives*, Vol. 20, Issue 15, June 20, 2014.
- “SEC Guidance on Reg FD for Social Media Communication”, *Corporate Compliance Insights*, May 29, 2013, co-authored with Karina Bjelland.
- Speaker, Hedge Fund Regulation Conference, London, United Kingdom, November 22, 2010.
- “Hedge Fund Disclosure: The Best Defense for an Industry Under Siege”, by Adam Cohen with contribution from Charles Lundelius, *FTI Journal*, Spring 2010, Issue 2.
- “Keeping Track of Funds To Avoid Getting Sued and Other Nasty Things”, presentation at the Treasurers Workshop sponsored by the Episcopal Diocese of Washington, December, 2008.

- “Insurers Face Repercussions of New Accounting Options”, *National Underwriter Property & Casualty*, December 10, 2007, co-authored with Mark Radke and John Pruitt of Dewey & LeBoeuf, LLP.
- Presentation and panel discussion at the International Reinsurance Summit, Bermuda, June 8, 2007, on reinsurance investigations and auditing procedures involving side agreements and other issues.
- “Risk Analyses Unique to Emerging Markets,” *Financier Worldwide*, March, 2007.
- “Reinsurance Accounting Issues,” Presentation for Practising Law Institute *Reinsurance Law and Practice* seminar, October 7, 2005.
- “Where to find fraud in closely held companies”, *The Practising CPA*, November 2003 [adaptation of Chapter 5 of *Financial Reporting Fraud: A Practical Guide to Detection and Internal Control*].
- “Disclosing Guesswork,” *The National Law Journal*, September 8, 2003.
- “Balance sheet becomes breeding ground for fraud”, *Journal of Accountancy*, May 2003 [adaptation of Chapter 4 of *Financial Reporting Fraud: A Practical Guide to Detection and Internal Control*].
- *Financial Reporting Fraud: A Practical Guide to Detection and Internal Control*, a book published by the American Institute of Certified Public Accountants, first edition 2003, second edition 2010.
- “Risk Management and the Audit Committee,” (co-author) *The Corporate Board*, September/October 2002
- Before the American Institute of CPAs’ National Conference on Fraud:  
October 31, 2002 - “CPA’s Role in Securities Litigation”  
October 2, 2003 - “Forensic Accounting Case Studies”
- “Reducing the Risk of Financial Statement Fraud,” Chapter 10 of *The CPA’s Handbook of Fraud and Commercial Crime Prevention*, American Institute of Certified Public Accountants, March 2001.
- Presentation on financial reporting issues at the Eastern Region Fraud Conference, November 3, 2000.
- “Role of Forensic Accounting in Securities Class Action Law Suits,” presentation at the New York office of Fried, Frank, Harris, Shriver & Jacobson, January 25, 2000.
- “Post Reform Act Standards for Pleading and Proving Scienter,” seminar sponsored by Deloitte & Touche LLP and Kirkpatrick & Lockhart LLP, October 19, 1999.
- “How Much Is A Stock Worth?” article in *Hearsay* (published by Deloitte & Touche LLP), May

1999.

- “Beyond SAS 82: International Issues in Fraud & Forensic Accounting,” before the faculty and students of the University of Virginia McIntire School of Commerce, October 21, 1998.

### **Certifications**

Certified Public Accountant

Accredited in Business Valuation

Certified in Financial Forensics

### **Professional Affiliations**

American Institute of Certified Public Accountants

Beta Alpha Psi Honorary Accounting Fraternity

Beta Gamma Sigma Honorary Business Fraternity

### **Education**

M.B.A. with a concentration in Finance, Tulane University, 1980

B.S. in Commerce with a major in Accounting, University of Virginia, 1978

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<i>Year</i>	<i>Case</i>	<i>Court/ Agency</i>	<i>Case or Docket No.</i>	<i>Party Represented</i>	<i>Deposition</i>	<i>Trial/ Hearing</i>
2015	Gleacher & Company Securities, Inc. v. Robert W. Baird & Co. Incorporated, <i>et al.</i>	Financial Industry Regulatory Authority	13-00608	Claimant		2
2014	[Individual] v. Jackson National Life Insurance Co. and Prudential, PLC.	U.S. Dept. of Labor	2013-SOX-00047	Respondents	1	
2014	The People of the State of New York v. Maurice R. Greenberg and Howard I. Smith	Supreme Court of the State of New York – New York County	401720/05	Defendants	1	
2014	Massachusetts Mutual Life Insurance Company v. Countrywide Financial Corporation, <i>et al.</i>	U.S. Dist. Ct., Massachusetts	11-cv-10414-MRP	Respondent	1	
2014	Hillcrest Children’s Center, <i>et al.</i> v. Charles Schwab & Co., Inc.	Financial Industry Regulatory Authority	13-00664	Respondent		1
2014	Acument Global Technologies, Inc., <i>et al.</i> v. Towers Watson & Co., <i>et al.</i>	U.S. Dist. Ct., S.D. New York	1:12-cv-00506-LLS	Plaintiff	1	
2014	Pasha Anwar, <i>et al.</i> v. Fairfield Greenwich Limited, <i>et al.</i>	U.S. Dist. Ct., S.D. New York	09-cv-118	Defendant	1	
2013	Pine Street Associates, L.P. v. Southridge Partners, L.P., Southridge Capital Management, LLC, and Southridge Advisors, LLC	Supreme Court of the State of New York, County of New York	652109/2010	Respondent	1	
2013	Eastham Capital Appreciation Fund LP, et al., v. KPMG LLP	International Institute for Conflict Prevention & Resolution		Respondent		1
2013	Texas A&M Foundation v. Strategic Investment Management, L.P. and Strategic Investment Partners, Inc.	American Arbitration Association	16 148 Y 00396 10	Claimants		1
2013	Anders and Elizabeth Hejlsberg, derivatively on behalf of Cornerstone Alternative Fixed Income Fund, L.P., as a Limited Partner, v. Cornerstone Portfolio GP, LLC, Keith J. Schafer, Robert Trenner, Kenneth Hart and Cornerstone Advisors, Inc.	American Arbitration Association	75-512-Y-000062-12 JMLE	Claimants	1	
2012	Securities and Exchange Commission v. Southridge Capital Management LLC, Southridge Advisors LLC, and Stephen M. Hicks	U.S. Dist. Ct., Connecticut	3:10-cv-01685	Defendant	1	

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2012	Securities and Exchange Commission v. Kimon P. Daifotis and Randall Merk	U.S. Dist. Ct., N.D. California	CV-11-cv-137	Defendant	1	
2012	State Compensation Insurance Fund v. Metropolitan West Securities LLC; Wachovia Bank, N.A.; <i>et al.</i>	U.S. Dist. Ct., N.D. California	CV 09 2959 JSW (EDL)	Defendant	1	
2011	Securities and Exchange Commission v. Lisa C. Berry	U.S. Dist. Ct., N.D. California	C-07-04431 RMW	Defendant	1	
2011	Securities and Exchange Commission v. R. Brooke Dunn and Nicholas P. Howey	U.S. Dist. Ct., Nevada	2:09-CV-02213-PMP-LRL	Defendant	1	
2011	Securities and Exchange Commission v. Reserve Management Company, Inc., Resrv Partners, Inc., Bruce R. Bent, Sr. and Bruce R. Bent II	U.S. Dist. Ct., S.D. New York	09 Civ. 4346 (PGG)	Defendant	1	
2011	Hampton Investments, Ltd.; Oakdale Investments, Ltd.; Seacliff Investments, Ltd.; and Stephen Finlay v. GPS Partners, LLC; GPS New Equity Fund (Cayman), Ltd.; and GPS Income Fund (Cayman), Ltd.	American Arbitration Association	50512 T 00097 10	Defendant		1
2010	Elliot Horowitz v. Gardner Lewis Asset Management	California Superior Court for the County of Los Angeles	BC406551	Defendant	1	1
2009 - 10	Securities and Exchange Commission v. Carl W. Jasper	U.S. Dist. Ct., N.D. California	CV 07-6122	Defendant	1	1
2008	Charles O. Bradley Trust, et al., v. Zenith Capital, LLC, <i>et al.</i>	U.S. Dist. Ct., N.D. California	C 04 2239 JSW (EMC)	Plaintiff	1	
2008	Kim Holland, Insurance Commissioner of the State of Oklahoma, in her capacity as Receiver of Petrosurance Casualty Company, in liquidation, and on behalf of Insureds and Creditors v. Charles Ray Lovelace; Murrell, Hall, McIntosh & Co., PLLP, <i>et al.</i>	District Court – 44 <sup>th</sup> Judicial District, Dallas County, Texas	04-01687-B	Defendant	3	1
2006	Steven Maass v. E*Trade Professional Trading, LLC, <i>et al.</i>	Financial Industry Regulatory Authority	03-01763	Respondent		1
2006 - 8	Securities and Exchange Commission v. Competitive Technologies, Inc., <i>et al.</i>	U.S. Dist. Ct., Connecticut	3:04-cv-1331-JCH	Defendant	1	2
2005 - 6	The Osage Nation and/or Tribe of Indians of Oklahoma v. The United States of America	Federal Claims Ct.	99-550 & 00-169 L	Defendant	1	1

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2005 - 6	Breed Technologies, Inc. v. AlliedSignal, Inc.	FL Cir. Ct., 10 <sup>th</sup> Dist.	G-99-2478	Plaintiff	3	2
2005	In re: Galaxy Computer Services, Inc.	U.S. Dist. Ct., E.D. Va.	CA 1:2004CV1036	Plaintiff		1
2005	National Association of Securities Dealers Department of Enforcement v. Invemed Associates, LLC	Financial Industry Regulatory Authority	Disciplinary Proceeding No. 030014	Respondent		1
2005	Jo Ann Oster, et al. v. CIBC World Markets Corp., et al.	Financial Industry Regulatory Authority	03-07585	Respondent		1
2004	National Rural Electric Cooperative Association, et al. v. Breen Capital Services Corporation, et al.	U.S. Dist. Ct., New Jersey	2:00cv00722	Plaintiff	1	
2004	U.S. v. Nathan A. Chapman, Jr.	U.S. Dist. Ct., Maryland	WDQ-03-0301	Defendant		1
2004	Securities and Exchange Commission v. David Gane, et al.	U.S. Dist. Ct., S.D. Florida Miami Division	03-61553-CIV- Seitz/Bandstra	Defendant	1	1
2004	Mountain States Mutual Casualty Company v. UBS PaineWebber, Inc.	Financial Industry Regulatory Authority	02-05813	Respondent		1
2003	Hermann Holdings, Ltd., et al. v. Lucent Technologies Inc.	U.S. Dist. Ct., N.D. Texas	3:01-CV-0625-G	Defendant	1	
2003	In re: The Receivership of Dealers Insurance Company	Second Judicial Circuit Court, Leon County, Fl.	94-4009-A	Defendant	1	1
2002	In re: SpaceWorks, Inc.	U.S. Bankruptcy Court, Md.	01-17875-PM	Unsecured Creditors	1	1
2001	InterVest Financial Services, Inc. v. Bear Stearns Co., Inc., et al.	U.S. Dist. Ct., E.D. Pa.	99-CV-5463	Defendant	1	
2001	Carabetta v. Novadigm, Inc., et al.	American Arbitration Association	74 160 01455 00 AD1	Plaintiff	1	1
2000	Bennett v. Wheat First Union, et al.	Financial Industry Regulatory Authority	99-02219	Plaintiff		1
1999	Helman v. Mendelson, et al.	Circuit Court of Maryland for Montgomery County	CA 195927 cons 195925	Plaintiff	1	

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1999	In the Matter of WHX Corporation	United States Securities and Exchange Commission	3-9634	Respondent		1
1999	American Federal Savings Bank v. Harry L. Leavy	Circuit Court of Maryland for Montgomery County	167641-V	Plaintiff		1
1998	Berliner Specialty Distributors v. Conopco a/k/a Good Humor-Breyers Ice Cream	U.S. Dist. Ct., E.D. Va.	98-143-A	Defendant	1	1
1998	Associated Financial Group v. Chevy Chase Bank	U.S. Dist. Ct., E.D. Va.	2:97 CV 985	Defendant	1	
1997	White v. Cahoon and Anchor National, <i>et al.</i>	U.S. Dist. Ct., N.D. Miss.	4:95 CV 374-B-B	Plaintiff	1	
1997	Powter v. Nutri/System L.P. <i>et al.</i>	U.S. Bkcty. Ct., C.D. Cal.	LA 95-10009-SB	Plaintiff	1	
1997	Weiner, <i>et al.</i> v. Dickinson & Co., <i>et al.</i>	Financial Industry Regulatory Authority	95-04047	Plaintiff		1
1996	Robinson v. R&R Publishing, Inc.	U.S. Dist. Ct., D.C.	95-CA-00833	Plaintiff/ Cross-Defendant		1
1996	Frank W. Griswold, III, <i>et al.</i> v. The United States of America	U.S. Dist. Ct., M.D. Fla.	93-565-CIV-T-23A	Defendant	1	
1995-1996	In the Matter of Lend Lease Trucks, Inc.	Pennsylvania Department of Revenue and Board of Finance and Revenue	421919 MCRT	Petitioner	1	1
1995	Simos v. Metzger Construction Co. and Sub-Zero Freezer Co.	125 <sup>th</sup> Judicial Dist. Ct. of Harris Co., Tex.	91-016216	Plaintiff		1
1994	Forman Brothers, <i>et al.</i> , v. The Law Firm of Graham & James, <i>et al.</i>	Superior Ct. for the District of Columbia	CA 92-7919	Defendant	1	
1994	Stoneman v. Stoneman	Henrico Co., Va. Cir. Ct.	CH-91- 001234	Plaintiff	1	*
1994	Ace Sign v. Southwestern Bell Yellow Pages, Inc.	58 <sup>th</sup> Judicial Dist. Ct., Jefferson Co., Tex.	A-137,152	Defendant	1	

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1993	UST Services, Inc., v. Southwestern Bell Yellow Pages, Inc.	234 <sup>th</sup> Judicial Dist. Ct., Harris Co., Tex.	91-055806	Defendant	1	
1992-1994	Tele-A-Call Answering Service v. Southwestern Bell Yellow Pages, Inc.	122 <sup>nd</sup> Judicial Dist. Ct., Galveston Co. Tex.	90CV0917	Defendant	1	1

\* Deposition testimony entered at trial.

## **Appendix B – Materials Relied Upon**

### **Bates Stamped Documents**

DOE-APP000001 – DOE-APP000045 (SEC Investigative Transcript of Respondent Traci Jo Anderson, taken on Friday July 25, 2014).

DOE-APP000046 – 000097 (SEC Investigative Transcript of Respondent Timothy W. Carnahan, taken on June 19, 2014).

DOE-APP000127 – DOE-APP000128 (Investigative Exhibit 6, biographical excerpts from CYIOS' public website).

DOE-APP000211 – DOE-APP000255 (CYIOS' 2009 Form 10-K/A for the fiscal year ended December 31, 2009).

DOE-APP000256 – DOE-APP000287 (CYIOS' 2010 Form 10-K/A, Amendment No. 2, for the fiscal year ended December 31, 2010).

DOE-APP000288 – DOE-APP000321 (CYIOS' 2010 Form 10-Q for the quarter ended March 31, 2010).

DOE-APP000322 – DOE-APP000337 (CYIOS' 2010 Form 10-Q for the quarter ended June 30, 2010).

DOE-APP000338 – DOE-APP000362 (CYIOS' 2010 Form 10-Q for the quarter ended September 30, 2010).

### **Auditing Standards**

PCAOB, Auditing Standard No. 5, An Audit of Internal Control Over Financial Reporting That is Integrated With an Audit of Financial Statements (PCAOB Release No. 2007-005A, June 12, 2007).

AICPA, Statement on Internal Auditing Standards No. 1, Control: Concepts and Responsibilities, 1983.

AICPA, Statement on Auditing Standards No. 30, Reporting on Internal Accounting Control, July 1980.

AICPA, Statement on Auditing Standards No. 43, Omnibus Statements on Auditing Standards, August 1982.

AICPA, Statement on Auditing Standards No. 48, The Effects of Computer Processing On the Examination of Financial Statements, July 1984.

### **SEC & PCAOB Releases**

SEC Release No. 9725, No. 74273, No. 3638, and File No. 3-16386: Order Instituting Administrative and Cease-And-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, Sections 4C and 21C of the Securities Exchange Act of 1934, and Rule 102(e) of the Commission's Rules of Practice, In the Matter of Traci J. Anderson, CPA, Timothy W. Carnahan, and CYIOS Corporation, February, 13, 2015.

SEC Release No. 2786, File No. 3-16386, Order on Motions for Summary Disposition, in the matter of Traci J. Anderson, CPA, Timothy W. Carnahan, and CYIOS Corporation, June 9, 2015.

SEC Release No. 33-8238, 34-47986, IC-26068, File Nos. S7-40-02, S7-06-03, Management's Report on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports, June 5, 2003.

PCAOB Release No. 105-2010-007, Order Instituting Disciplinary Proceedings, Making Findings, And Imposing Sanctions, In the Matter of Traci Jo Anderson and Traci Jo Anderson, CPA, Respondents, August 12, 2010.

SEC Release Nos. 33-8810; 34-55929; FR-77; File No. S7-24-06, Commission Guidance Regarding Management's Report on Internal Control Over Financial Reporting Under Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (17 CFR Part 241), June 20, 2007.

### **Securities and Exchange Act & Sarbanes-Oxley Act**

Securities and Exchange Act of 1934, Rule 13a-15(d) (17 CFR 240.13a-15).

Securities and Exchange Act of 1934, Rule 15d-15(d) (17 CFR 240.15d-15).

Sarbanes-Oxley Act of 2002, Section 105: Investigations and Disciplinary Proceedings, July 30, 2002.

Sarbanes-Oxley Act of 2002, Section 206: Conflicts of Interest, July 30, 2002.

Sarbanes-Oxley Act of 2002, Section 302: Corporate responsibility for financial reports, July 30, 2002.

Sarbanes-Oxley Act of 2002, Section 304: Forfeiture of certain bonuses and profits, July 30, 2002.

Sarbanes-Oxley Act of 2002, Section 401: Disclosures in periodic reports, July 30, 2002.

Sarbanes-Oxley Act of 2002, Section 404: Management Assessment of Internal Controls, July 30, 2002.

Sarbanes-Oxley Act of 2002, Section 409: Real time issuer disclosures, July 30, 2002.

Sarbanes-Oxley Act of 2002, Section 906: Corporate Responsibility for Financial Reports, July 30, 2002.

### **Books**

Lundelius Jr., Charles, *Financial Reporting Fraud: A Practical Guide to Detection and Internal Control*, Second Addition, AICPA, 2010.

Committee of Sponsoring Organizations of the Treadway Commission, *Internal Control – Integrated Framework, Volume 1*, 1994 (Executive Summary, Framework, Reporting to External Parties, September 1992; Addendum to “Reporting to External Parties”, May 1994).

Committee of Sponsoring Organizations of the Treadway Commission, *Internal Control – Integrated Framework, Volume 2*, 1994 (Evaluation Tools, September 1992).

Fabozzi, Frank J., Pamela Peterson Drake, Ralph S. Polimeni, *The Complete CFO Handbook: From Accounting to Accountability*, John Wiley & Sons, 2008.

CFA Institute, *Standards of Practice Handbook*, Tenth Edition 2010.

Bragg, Steven M., *The New CFO Financial Leadership Manual*, Second Edition, John Wiley & Sons, 2007.